No. 90-727-CFX
Status: GRANTED

Title: Robert G. Holmes, Jr., Petitioner
v.
Securities Investor Protection Corporation, et al.

Docketed:
November 1, 1990

Court: United States Court of Appeals
for the Ninth Circuit

Counsel for petitioner: Samet,Jack I.

Counsel for respondent: Taylor,Stephen C., Simpson,C. Edward

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3	Dec 13 1990		Brief of respondents in opposition filed.
4	Jan 9 1991		Reply brief of petitioner Robert Holmes filed.
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6	Apr 22 1991		Petition GRANTED. limited to Question 1 presented by the petition.
			**********
7	Jun 6 1991		Joint appendix filed.
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8	Jun 6 1991		Brief amici curiae of Arthur Andersen & Co., et al. filed.
9	Jun 6 1991		Brief amicus curiae of American Institute of Certified Public Accountants filed.
10	Jun 6 1991		Brief of petitioner Robert Holmes filed.
11	Jul 9 1991		Brief of respondent Securities Investor Protection Corporation filed.
12	Jul 9 1991		Brief amicus curiae of National Assn. of Securities and Commercial Law Attorneys filed.
13	Jul 30 1991		CIRCULATED.
16	Aug 2 1991		Record filed.
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14	Aug 9 1991	X	Reply brief of petitioner Robert Holmes filed.
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No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
Petitioner,
VS.
SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, Trustee for the Liquidation of Joseph Sebag Incorporated, and LAURENCE A. SCHROEDER, Successor Trustee for the Liquidation of First State Securities Corporation,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a party which was neither a purchaser nor a seller of securities, and for that reason lacked standing to sue under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, is free of that limitation on standing when presenting essentially the same claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

2. Whether liability under RICO, or under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, may be imposed against a defendant, as a co-conspirator, when his own conduct has no causal connection to the harm sustained by the plaintiff.

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No.

In the Supreme Court

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ROBERT G. HOLMES, JR.,
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VS.
SECURITIES INVESTOR PROTECTION CORPORATION,
EUGENE W. BELL, Trustee for the Liquidation of
Joseph Sebag Incorporated, and LAURENCE A.
SCHROEDER, Successor Trustee for the Liquidation of
First State Securities Corporation,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The Opinion and Judgment of the United States Court of Appeals for the Ninth Circuit is reported at 908 F.2d 1461 (9th Cir. 1990) and is printed in Appendix A hereto, *infra*, page 22a. The Orders for Summary Judgment of the United States District Court for the Central District of California are printed in Appendix A hereto, *infra*, pages 22a-46a. Other opinions rendered at earlier points in this case by the United States Court of Appeals for the Ninth Circuit are reported at 764 F.2d 1309 (9th Cir. 1985) and at 803 F.2d 1513 (9th Cir. 1986) and are

printed in Appendix A hereto, *infra*, pages 64a and 46a, respectively.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit (Appendix A, *infra*, page 1a) was entered on August 3, 1990. The jurisdiction of the Supreme Court is invoked under 28 U.S.C. § 1254(1) and Rule 10.1(a) of the Rules of the Supreme Court of the United States.

STATUTES INVOLVED

1. The Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C.A. §§ 1961-68 (West. 1984), printed in Appendix A hereto, *infra,* page 86a.

2. The Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b) (Law Co-op. 1983) and Securities and Exchange Commission Rule 10b-5, 17 CFR § 240.10b-5, printed in Appendix A hereto, *infra,* page 97a.

3. The Securities Investor Protection Act, 15 U.S.C.S. §§ 78aaa-78lll (Law. Co-op. 1983), printed in Appendix A hereto, *infra,* page 98a.

STATEMENT OF CASE

I.

Background

In 1983, the Securities Investor Protection Corporation ("SIPC") and the trustees of two failed securities brokerage firms, First State Securities Corporation ("FSSC") and Joseph Sebag, Inc. ("Sebag") brought this action against seventy-five defendants including the

petitioner, Robert G. Holmes, Jr. ("Holmes"). FSSC and Sebag had previously been placed in liquidation by SIPC in 1981 after FSSC and Sebag failed to meet statutory net capital requirements. SIPC and the trustees sued to recover losses sustained as a result of an alleged conspiracy among the defendants, including Holmes, to manipulate, through FSSC and Sebag, the prices of stocks of six publicly traded corporations. SIPC and the trustees asserted claims under the Racketeer Influenced And Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO") and the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder.[1]

II.

The Parties To The Appeal Below

Holmes, the petitioner herein, is the founder, chief executive officer, president and a major shareholder of Aero Systems, Inc. ("Aero.") Aero is one of the six corporations whose stock SIPC alleges was manipulated. Holmes was also a major shareholder of Bunnington Corporation ("Bunnington"), another of the six corporations whose stock was allegedly manipulated.

SIPC, one of the appellants below, was established in 1970 by the Congress pursuant to the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa-78111. Among other purposes, SIPC was empowered to reimburse customer claims when member securities brokerages went into liquidation due to financial failure and had insufficient assets to meet customer claims. SIPC alleges that it had

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[1]Section 10(b), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 CFR § 240.10b-5., Appendix A, hereto, *infra*, pages 97a and 98a respectively.

to disburse nearly $13,000,000 to meet claims of customers of FSSC and Sebag which FSSC's and Sebag's assets were insufficient to statisfy. SIPC sued to recover those losses from Holmes and other defendants. The trustees, the other appellants below, were appointed to liquidate FSSC and Sebag and separately sued Holmes for the destruction of the business and loss of goodwill of FSSC and Sebag.

III.

The Proceedings Below

Holmes moved for summary judgment in the District Court for the Central District of California (the "District Court") on the grounds, among others, that SIPC had no standing to maintain claims against him under Section 10(b) and Rule 10b-5 of the Exchange Act because SIPC was not a purchaser or seller of securities. Holmes also asserted that he was not liable to either SIPC or to the trustees because his acts, taken alone or in conjunction with those of others, were not the proximate cause of the financial failure of the brokerages. Holmes also argued that SIPC and the trustees had no standing under RICO to sue him for the failure of the brokerages because SIPC's and the trustees' damages were not caused "by reason of" the alleged RICO violations. Furthermore, SIPC did not have standing to assert RICO claims against Holmes which were predicated upon Holmes' alleged predicate offenses under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC, not having been a purchaser or seller of the securities, had no standing to assert the alleged predicate claims.

In the courts below, SIPC and the trustees argued that Holmes, acting in concert with others, caused the demise of FSSC and Sebag by artificially inflating the price of

Aero's stock through the issuance of false and misleading press releases. The plaintiffs argued that the alleged inflated price of Aero stock enabled the brokerages to acquire massive inventories of other allegedly manipulated stock. The plaintiffs argued that these excess inventories were the reason for FSSC's and Sebag's failure because the price of the stocks dropped when the alleged manipulation was discovered.

SIPC and the trustees also alleged that Holmes assisted other defendants to manipulate the price of Bunnington stock by controlling the supply of the stock while helping to create the illusion of an active market in the stock. They further alleged that Holmes assisted the principals of FSSC to hide FSSC's poor financial condition from regulatory authorities by allowing FSSC to "park" shares of Bunnington stock in Holmes' trading account.

Holmes denied inflating the price of Aero's stock artificially and argued that even if he did, that manipulation was not the cause of the failure of the brokerages. The failure of the brokerages was caused by wrongdoing of Joseph Lugo, a principal and brokerage officer of FSSC and Rodger Garrity, a former brokerage officer of Sebag, who manipulated securities between themselves and engaged in other wrongdoing, none of which involved Holmes. Holmes contended that there was no evidence that Holmes' trading in Bunnington stock was in assistance of the alleged manipulation of Bunnington stock by others. Holmes also produced evidence to show that conduct which plaintiffs alleged constituted "parking" of Bunnington shares was lawful and proper and there was no "parking" of securities.

A. The District Court's Rulings

In ruling on Holmes' motions for summary judgment, the District Court concluded that Holmes' conduct was not sufficiently connected to SIPC's and the trustees' losses to have been a proximate cause of those losses. The District Court further concluded that although there were genuine issues of fact as to whether Holmes conspired to violate RICO, there was no genuine dispute that SIPC was not a purchaser or seller of securities and that SIPC therefore had no standing to assert RICO claims predicated upon violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Furthermore, the District Court concluded that Holmes was entitled to summary judgment with respect to both the Exchange Act claims and the RICO claims because Holmes' conduct was not causally connected to SIPC's and the trustees' losses. The District Court therefore granted summary judgment to Holmes on both the Rule 10b-5 and the RICO claims for the same reason, that is, the lack of a causal nexus between Holmes' conduct and the plaintiffs' losses.

The District Court noted, in its conclusions of law, that the grant of summary judgment to Holmes with respect to both the Exchange Act and RICO claims was because the "proximate cause" requirement under RICO was no different than the "loss causation" requirement under the securities laws. In essence, therefore, the District Court concluded that Holmes' conduct (i.e. the very overt acts claimed by SIPC and the trustees to have aided the conspiracy) was not causally connected to the claimed losses.

B. The Ninth Circuit's Reversal

The Court of Appeals for the Ninth Circuit reversed the District Court and stated that even though Holmes' own

conduct was not causally connected to the harm alleged, if Holmes was a conspirator then he was legally responsible for SIPC's and the trustees' losses, as long as Holmes' co-conspirators caused SIPC's and the trustees' losses. The Ninth Circuit also held that SIPC need not have been a purchaser or seller of securities in order to acquire standing to assert RICO claims predicated upon Holmes' alleged Section 10(b) and Rule 10b-5 violations.

BASIS FOR FEDERAL JURISDICTION IN THE DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

Respondents SIPC and the trustees invoked Federal jurisdiction in the United States District Court for the Central District of California on the basis of 28 U.S.C. § 1331; 18 U.S.C. § 1961 *et. seq.*; and 15 U.S.C. §§ 78a *et. seq.*

REASONS FOR GRANTING WRIT

I.

The Decision Of The United States Court Of Appeals For The Ninth Circuit, Giving A Plaintiff Who Is Not A Purchaser Or Seller Of Securities Standing To Sue Under RICO, Based Upon Alleged Violations Of Section 10(b) Of The Exchange Act And Rule 10b-5 Thereunder, Is In Conflict With Opinions Of The Fourth And Eighth Circuits And Certiorari Should Therefore Be Granted To Resolve The Conflict Among The Circuits In This Important Area Of Federal Securities Fraud Law

The Ninth Circuit has decided, in this action, that there is no requirement under RICO for a plaintiff to be a purchaser or seller of securities in order to have standing

to assert a RICO claim on the basis of predicate acts violative of Section 10(b) and Rule 10b-5 of the Exchange Act. This position conflicts with those of the Fourth and Eighth Circuits which positions have been adopted by the district courts of several other circuits, including the District Court below.[2]

The judgment and opinion of the Ninth Circuit also undermines the well-developed "standing" limitations which have been nurtured over forty years of federal securities law. These "standing" limitations exclude remote parties to a securities transaction, such as SIPC in the instant case, from recovering damages in a private action against one of the parties to the securities transaction.

In the instant case, plaintiff SIPC was not a purchaser or seller of any securities and failed to show, in the District Court, that it was subrogated to the claims of any of FSSC's or Sebag's customers who had unauthorized transactions in their accounts and who were themselves purchaser or sellers of securities.[3] SIPC, in effect, was a

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[2]*See International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987); *Brannan v. Eisenstein*, 804 F.2d 1041, 1046 (8th Cir. 1986); *Chief Consol. Mining Co. v. Sunshine Min. Co.*, 725 F.Supp 1191, 1194 (D. Utah 1989); *Data Controls North, Inc. v. Financial Corporation of America*, 688 F.Supp. 1047, 1052 (D. Md. 1988) (in dicta, the court suggested that on the basis of *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987) plaintiffs who had no legally cognizable action for securities fraud under the Exchange Act would have no standing to present their claims under RICO).

[3]SIPC was required to make such a showing in order to acquire standing under the Exchange Act, pursuant to an earlier opinion in this case by the United States Court of Appeals for the Ninth Circuit, *SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986), Appendix A hereto, *infra*, page 46a.

stranger to the securities transactions of which it complained.

SIPC was required, under the Securities Investor Protection Act, 15 U.S.C.S. §§ 78aaa-78lll, to reimburse customers of the failed brokerages if the brokerages' assets were insufficient to meet customer claims against the brokerages. SIPC's statutory duties, however, in no way grant to SIPC automatic standing to assert claims which SIPC is otherwise disabled from asserting by virtue of not being a direct victim of the alleged securities fraud.

The Ninth Circuit has concluded, however, that a plaintiff, such as SIPC, suing under RICO and predicating the RICO suit upon alleged offenses involving fraud in the sale of securities, need not himself be a purchaser or seller of securities. Here, SIPC predicated its RICO claims against Holmes on Holmes' alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Ninth Circuit's decision will enable plaintiffs who are without standing to assert claims based upon securities fraud to circumvent the standing limitations imposed by the purchaser-seller rule by the simple expedient of merely re-casting and pleading such claims as RICO claims. Under the Ninth Circuit's opinion, for which review is here sought, plaintiffs who could not have sued under Section 10(b) and Rule 10b-5 may now recover treble damages under RICO for the same conduct.

The Ninth Circuit is aligned in its view of the law with the Eleventh Circuit. The Ninth and Eleventh Circuits' rationale of their decisions is that RICO has no express purchaser-seller "standing" requirement similar to that

necessary to assert claims under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[4]

The Eighth and Fourth Circuits have held contrary to the Ninth and Eleventh Circuits.[5] The Fourth Circuit's decision in *International Data Bank, Ltd. v. Zepkin,*[6] supports Holmes' contention that if a plaintiff predicates his RICO claims on Rule 10b-5 offenses, then the plaintiff must be a purchaser or seller of securities in order to have standing to pursue such RICO claims. In *Zepkin,* the Fourth Circuit held that a RICO plaintiff who had neither purchased nor sold securities had no standing to sue under RICO where the RICO claims were predicated upon fraud in the sale of securities.[7]

In an earlier appeal in the instant case, the Ninth Circuit held that SIPC had standing to assert Section 10(b) and Rule 10b-5 claims in this case only if SIPC could show that it was subrogated to the claims of customers of FSSC and Sebag who were victims of unauthorized transactions in their accounts.[8] In the District Court, SIPC was unable to adduce any evidence of such

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[4]*SIPC v. Holmes,* 908 F.2d 1461, 1470 (9th Cir. 1990), Appendix A, hereto, *infra,* page 1a; *Warner v. Alexander Grant & Co.,* 828 F.2d 1528, 1530 (11th Cir. 1987).

[5]*See International Data Bank, Ltd. v. Zepkin,* 812 F.2d 149 (4th Cir. 1987); *Brannan v. Eisenstein,* 804 F.2d 1041, 1046 (8th Cir. 1986).

[6]812 F.2d 149 (4th Cir. 1987).

[7]*Id.* at 155.

[8]*SIPC v. Vigman,* 803 F.2d 1513 (9th Cir. 1986), Appendix A, hereto, *infra,* page 46a.

unauthorized transactions and was therefore unable to establish that it was a purchaser or seller of securities.[9]

In holding that RICO does not require a plaintiff to be a purchaser or seller of securities in order to have standing to sue under RICO based upon predicate acts of Rule 10b-5 violations, the Ninth Circuit stated that to sue, the plaintiff need only be one "who is injured 'by reason of' fraud in the sale of securities . . . ."[10] However, this rule of standing under RICO,[11] to which the Ninth Circuit adverted, requires the plaintiff to be a proximate victim of the fraud of which he complains.[12] The "standing" limitation imposed upon non-purchasers and non-sellers of securities under Rule 10b-5 is simply a judicial recognition that such plaintiffs are not directly or proximately

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[9]*See* District Court's Conclusions of Law No's. 1 through 6 contained in the Statement of Uncontroverted Facts In Support of Motion For Summary Judgment That SIPC Lacks Standing To Assert Claims Under 1934 Securities Exchange Act, Section 10(b) and Rule 10b-5, Appendix A, hereto, *infra,* pages 22a-28a.

[10]*SIPC v. Holmes,* 908 F.2d 1461, 1466 (9th Cir. 1990), Appendix A, hereto, *infra,* page 1a.

[11]In *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 105 S.Ct. 3275, 87 L.Ed 2d. 346 (1985) this Court held that a plaintiff seeking to sue under RICO had standing only if he was injured "by reason of" the RICO violation.

[12]*See Id.* at 496-97 (" 'a defendant who violates [RICO] Section 1962 is not liable for treble damages to everyone he might have injured by other conduct, nor is the defendant liable to those who have not been injured.' ") (citing *Haroco, Inc. v. American National Bank & Trust Co. of Chicago,* 747 F.2d 384, 398 (1984), aff'd 473 U.S. 606, 105 S.Ct. 3291, 87 L.Ed. 2d 437 (1984).

injured by the conduct of which they complain.[13] SIPC is such a plaintiff here.

The Ninth Circuit also reasoned, in its decision below, that the purchaser-seller requirement under Rule 10b-5 is a judicially created limitation which was created because the Section 10(b) right of action is implied rather than expressly provided.[14] On the other hand, because the private civil action under RICO is expressly provided, the right to sue under RICO should not be circumscribed by the courts because RICO is to be read broadly "to effectuate its remedial purposes."[15]

The Ninth Circuit's decision, however, disregards what the Fourth Circuit recognized in *International Data Bank v. Zepkin,*[16] that is, the fact that the rule of "standing" under RICO is not one that has been clearly legislated and that imposing "traditional standing requirements for securities fraud" on the plaintiff does not run afoul of this Court's holding in *Sedima.* A non-purchaser or non-seller of securities, such as SIPC here, has at most only indirect injury from the alleged fraud. The proper party to assert the action is the person more proximately situated, that is, the purchaser or seller of the securities.[17]

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[13]*See International Data Bank v. Zepkin,* 812 F.2d 149, 152 (4th Cir. 1987).

[14]*SIPC v. Holmes,* 908 F.2d 1461, 1466 (9th Cir. 1990), Appendix A hereto, *infra,* page 1a.

[15]*Id.* (Citing this Court's opinion in *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985)).

[16]812 F.2d 149, 153-54 (4th Cir. 1987).

[17]In the instant case, in fact, plaintiffs who claimed to have been directly injured by the alleged stock manipulations filed a class action against the defendants which was consolidated with the instant case and subsequently settled. The language of this Court in *Sedima, S.P.R.L.* v. *Imrex Co.,* 473 U.S. 479, 496, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985) suggests the need for a *casual* connection between the injury and the conduct of the defendants ("... the plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation.")

The Ninth Circuit, like the Eleventh Circuit, has stated that the RICO statute facially has no requirement analogous to the 'purchase or sale' requirement of the federal securities laws.[18] Holmes respectfully submits, however, that the view of the Fourth Circuit in *International Data Corp. v. Zepkin,*[19] is the better reasoned view, safeguards defendants from unbridled liability from remote plaintiffs, and should therefore prevail.

In *Zepkin,* the Fourth Circuit held that since the plaintiff was neither a purchaser nor a seller of securities, it had no standing under RICO to pursue a claim predicated on a Rule 10b-5 offense. The Fourth Circuit based its conclusion on the rationale of *Blue Chip Stamps v. Manor Drugstores:*[20] "[P]arties who are affected by a securities fraud only indirectly cannot sue under Rule 10b-5."[21] The Fourth Circuit in *Zepkin* concluded that Congress intended to make "the actual sale transaction" pivotal for RICO standing.[22] The Fourth Circuit also reasoned that RICO was enacted against a backdrop of forty years of federal securities laws, and that had Congress intended "the drastic result of overturning this consensus, it surely

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[18]*SIPC v. Holmes,* 908 F.2d 1461, 1466 (9th Cir. 1990), Appendix A hereto, *infra,* page 1a; *Warner v. Alexander Grant & Co.,* 828 F.2d 1528, 1530 (11th Cir. 1987).

[19]812 F.2d 149 (4th Cir. 1987).

[20]421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975).

[21]812 F.2d at 152.

[22]*Id.*

would have done so in a more explicit way."[23] The Fourth Circuit noted that although the right of action under Section 10(b) of the Exchange Act is judicially implied and the right of action under RICO is express, "many elements of the RICO action, including that of standing, have not been clearly legislated."[24] The Fourth Circuit therefore concluded that the Rule 10b-5 purchaser-seller requirement is incorporated in RICO standing where the plaintiff predicates the RICO claim on "fraud in the sale of securities"[25] Holmes respectfully urges that the Court adopt the view of the Fourth Circuit.

Holmes respectfully submits that this Court should review the Ninth Circuit's judgment below because the rule it enunciates portends of grave consequences to legitimate businesses. The onslaught of civil RICO litigation against legitimate business concerns needs no reiteration. The opinion of the court below frees plaintiffs from the restriction imposed by the purchaser-seller requirement. Thus, the opinion is bound to foster litigation among plaintiffs previously disabled from suing for alleged securities fraud under the Exchange Act. Furthermore, the Ninth Circuit's opinion below threatens to make the purchaser-seller limitation altogether obsolete. To the extent that a plaintiff can allege a "pattern" of the claimed acts of securities law violations, the plaintiff may sue under RICO where he might have been unable to sue under the Exchange Act.

The instant case provides a perfect example of the specter of the type of litigation which businesses will face in light of the Ninth Circuit's opinion. Here, for instance,

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[23] *Id.* at 152.

[24] *Id.* at 153.

[25] *Id.* at 152, 155.

SIPC would have been unable to recover its claimed $13,000,000 loss from Holmes under the Exchange Act because SIPC was not a purchaser or seller of securities. The effect of the Ninth Circuit's opinion, however, is to allow SIPC to recover treble its claimed losses ($39,000,000 rather than $13,000,000) under RICO. Even were such damages insurable, the cost to society would be high. The financial ruin of legitimate businesses is not an unlikely result as the allure of treble damages almost certainly will increase litigation in this area.

Moreover, adequate protection for legitimate business concerns should not be assumed to exist simply because of a vigilant judicial and jury system. The complexity of issues such as causation, and the very breadth of the RICO statute, may ensnare business enterprises into liability that is punitive beyond the culpability of such enterprises. Furthermore, vexatious litigation, which the purchaser-seller requirement was designed to address, is bound to increase as plaintiffs utilize the threat of RICO treble damages to wrest settlements from business concerns. The coercion of settlements in securities fraud actions is a danger which was specifically recognized by this Court in *Blue Chip Stamps v. Manor Drugstores.*[26] For these reasons, this Court should grant certiorari to review the opinion of the Ninth Circuit on the purchaser-seller issue under RICO.

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[26] 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed 2d 539 (1975).

II.

The Decision Below By The United States Court Of Appeals For The Ninth Circuit Raises A Significant Question Of Federal Law That Should Be Settled By This Court, That Is, Whether One Who Is Alleged To Be A Conspirator Under RICO Or The Securities Laws May Be Held Liable Even Though His Conduct Has No Causal Connection To The Plaintiff's Injury.

In ruling on Holmes' motions for summary judgment, the District Court concluded that Holmes' conduct was not sufficiently causally connected to the plaintiffs' losses to be a proximate cause of the losses and granted Holmes' motions for summary judgment.

The Ninth Circuit reversed on the basis that *if* Holmes conspired with co-defendants, and *if* the co-defendants caused the alleged injuries, then Holmes is legally responsible even if he did not participate in every detail of the conspiracy.[27] In point of fact, however, the District Court did not find that there was an issue for trial of whether Holmes participated in the conspiracy that caused the loss of the brokerages. The District Court found that there was a genuine issue as to whether Holmes participated in a conspiracy to violate RICO, without making a finding about the presence or absence of any causal connection between this RICO conspiracy and the harm of which plaintiffs' complained.[28]

The District Court also concluded that Holmes' conduct was not the proximate cause of the brokerages'

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[27]*SIPC v. Holmes*, 908 F.2d 1461, 1468-69 (9th Cir. 1990), Appendix A hereto, *infra*, page 1a.

[28]Finding No. 5 in District Court's Order Granting Summary Judgment (RICO Claims), Appendix A hereto, *infra*, page 45a.

failure and that any manipulation by Holmes of Aero stock had no impact on the brokerage firms' net capital deficiencies. The District Court found that "there is no evidence that Holmes knowingly, willfully or intentionally" participated in a "scheme" to manipulate Bunnington stock.[29] Presumably, though the District Court did not expressly address the matter, the RICO conspiracy in which Holmes may have participated involved Aero securities (which related to the companion class action commenced by Aero shareholders) and which did not involve the unrelated losses sustained by the brokerages as a result of manipulation of securities other than Aero by former brokerage firm officers (Lugo and Garrity). In granting summary judgment in favor of Holmes on the RICO claims, the District Court stated, "the grant of summary judgment on 'causation' applies also to the RICO claims."[30]

On the state of the record, there was no finding of a genuine dispute concerning whether Holmes was a conspirator in any conspiracy that caused the brokerage firms' losses. Holmes was found by the Ninth Circuit to be legally responsible only *if* he conspired with co-defendants, and *if* the co-defendants caused the injuries to the brokerage firms. Conspicuous by its absence is any find-

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[29]District Court's Conclusions of Law Nos. 1, 2, 6, 8 and Uncontroverted Fact Statement No. 32 contained in Statement of Uncontroverted Facts and Conclusions of Law (Causation), Appendix A, hereto, *infra*, page 31a.

[30]Finding No. 9 (asterisked notation) in District Court's Order Granting Summary Judgment (RICO Claims), Appendix A, hereto, *infra*, page 46a; Although arguably ambiguous, Finding No. 8 in the Order Granting Summary Judgment (RICO Claims), should be read in this context to mean that there is no finding of a genuine issue concerning whether the RICO conspiracy in which Holmes may have participated caused the injuries to the brokerages.

ing by the District Court or ruling by the Ninth Circuit that there is a genuine issue of fact whether Holmes was a co-conspirator in the conspiracy that caused the brokerage firms' loss.

As matters now stand, Holmes may be subjected to liability as a co-conspirator in the absence of any finding that he engaged in any act sufficiently causally connected to the ultimate harm to render it just that Holmes be treated as a co-conspirator.[31] This Court should issue a writ of certiorari to review the Ninth Circuit's decision because the decision raises a question of substantial importance in federal RICO and securities fraud law, that is, whether a party may be subjected to liability as a co-conspirator when he engaged in no conduct that is causally related to the alleged injury.

It is clear that if Holmes had participated in a conspiracy which caused the brokerages' ruin, he furthered that alleged conspiracy only if he engaged in conduct that *was causally* related to the unlawful end. The District Court found that Holmes' conduct was not so causally related. If a defendant, therefore, whose conduct did not cause the plaintiff's injury may be found liable under a conspiracy theory for the acts of others with whom there is no

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[31]In order for one to be found a civil "conspirator," one must engage in tortious acts which further the conspiracy. *Restatement (Second) of Torts*, § 876(a) and Comment on Clause (a) at 316. In contrast, in criminal conspiracy, it is the *agreement* which is the keystone of liability and the overt act of any of the conspirators in furtherance of the conspiracy is sufficient to bind all of the co-conspirators for liability. *See generally* LaFave and Scott, *Criminal Law*, §§ 61-62 at 453-95, 455 n.21, 470, 476-78. In the instant case, no overt act (conduct) of Holmes was found by the District Court to have been causally related to the plaintiffs' injuries.

evidence he unlawfully agreed to assist, then justice departs from the law.

The rule that a conspirator is liable for the conduct of his co-conspirators is justifiable only if the alleged conspirator engages in conduct which advances the conspiracy.[32] If the alleged conspirator's conduct was not causally related to the injury then it is compelling that the alleged conspirator was not in fact a conspirator. To hold otherwise, as did the Ninth Circuit, widens the scope of liability to a defendant beyond reason.

Although it is well established that to be liable a conspirator's own conduct need not be the cause of the plaintiff's injury if some conduct of his co-conspirators caused the injury, it appears that, as a theory of secondary liability, some sufficient causal nexus should be required between the overt act of the alleged conspirator and the plaintiff's injury.

Such a causal connection should be required as a condition to determining that a particular individual is a co-conspirator, particularly since the law is well settled that once co-conspirator status is established no further causal connection between the conduct of the co-conspirator and the ultimate loss need be established.[33]

Under aiding and abetting theory, as a comparison, liability is imposed if the alleged aider 1) knew of a primary violation of law and 2) provided substantial

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[32]*See Restatement (Second) of Torts*, § 876(a), Comment on Clause (a) at 316.

[33]*See e.g., International Longshoremen's & Warehousemen's Union v. Juneau Spruce Corp.*, 189 F.2d 177, 190 (9th Cir. 1952), aff'd 342 U.S. 237, 72 S.Ct. 235, 96 L.Ed. 275.

assistance to the primary violator.[34] "Substantial assistance" has been described as a requirement for a causal connection between the conduct of the aider and the plaintiff's injury.[35] Conspiracy liability, on the other hand, requires 1) knowledge of the objective; 2) agreement to the unlawful objective or to the use of unlawful means to achieve a lawful objective and 3) an overt act or acts by the conspirators.[36]

An aider and abettor, however, is liable only when his conduct is causally related to the plaintiff's injury.[37] The aider must supply "substantial assistance."[38] Similarly, a conspirator should be subjected to liability only if he engages in some conduct that is causally related to the plaintiff's injury.[39] The elements of aiding and abetting and conspiracy liability are almost identical. Often, in fact, the same conduct is alleged to support both theories of liability. Yet it would appear, at least by virtue of the Ninth Circuit's opinion below, that while an aider and abettor must supply "substantial assistance" to the primary wrongdoer in order to be liable, a conspirator may

[34]*See e.g. Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57 (2nd Cir. 1985); *Restatement (Second) of Torts*, § 876(b) at 315.

[35]*Bloor, supra*, at 62.

[36]*See* 16 Am. Jur. 2d, *Conspiracy* §§ 50, 51 at 268 (1979).

[37]*Bloor, supra*, at 62.

[38]*Id.*

[39]The *Restatement* uses the term "tortious" in describing the conduct which renders a person a "conspirator." *See Restatement (Second) of Torts*, § 876(a) at 315. Implicit in that usage, though not expressly stated, is that the conduct must have a causal connection with the harm done. This requirement is blurred by the Ninth Circuit's decision below.

be found liable even if his conduct was not at all causally related to the plaintiff's injury.[40] This result is an aberration since proof of "knowledge" under aiding and abetting liability, coupled with the requirement of "assistance" will almost certainly also support an allegation of conspiracy. The proof that one gave "assistance" provides the basis of his alleged "agreement" to achieve the unlawful end.

Under the Ninth Circuit's decision below, the actor's own conduct is relegated to such an insignificant status that the concept of the conspiratorial "agreement" is elevated, as if in a criminal conspiracy, without valid reason, and the element of responsibility supplied by the concept of causation is thereby eliminated.

The instant case provides apt illustration of the illogic or eradicating any requirement of causation between the alleged conspirator's conduct and the plaintiff's injury. If Holmes was a conspirator, he should be found liable only if he *acted in furtherance of the conspiracy*. If he did not so act, then he should not be regarded as a conspirator in the first place with respect to the causing of the plaintiffs' injuries since merely agreeing to injure another, without more, cannot be the basis for liablility.[41] If Holmes' conduct was not causally connected to the harm suffered by the plaintiffs, then he should not be liable for the

[40]While this result may be justifiable under criminal conspiracy theory where the agreement to achieve an unlawful objective is the keystone for liability, such a result appears to be unjustifiable under civil conspiracy where the alleged conspirator's overt act is required to be "tortious." *See Restatement (Second) of Torts*, § 876(a) at 315.

[41]"The mere common plan, design or even express agreement is not enough for liability in itself, and there must be acts of a tortious character in carrying it into execution." *Restatement (Second) of Torts*, § 876(a) and Comment on Clause (a) at 316.

conduct of others in the face of uncontroverted facts that he did not knowingly assist others in doing the very things which plaintiffs asserted were the cause of the brokerages' financial failure.[42]

The relationship between the settled doctrines of conspiracy liability and the concept of causation should be more precisely articulated by this Court. Requirements of causation and instances of liability for conspiracy abound in the law. On its face, the two concepts seem to operate independently of each other. The degree to which, and circumstances under which, requirements of causation must be established before liability for conspiracy may be imposed should be addressed by this Court. Robert Holmes is only one of many litigants whose status, liability and rights could be more fairly and clearly understood if this Court will see fit to address the question.

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[42]District Court's Conclusions of Law 1, 2 and 8 and Uncontroverted Facts Statements 22, 32, 33 and 34 contained in Statement of Uncontroverted Facts and Conclusions of Law (Causation), Appendix A, hereto, *infra*, page 31a.

CONCLUSION

For the foregoing reasons, this Court should issue a Writ of Certiorari to review the Judgment of the Court of Appeals for the Ninth Circuit.

Dated: November 1, 1990

Respectfully submitted,

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Appendix

SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiff-Appellant,

v.

SEYMOUR VIGMAN, et al.,
Defendants,

and

ROBERT G. HOLMES, JR.,
Defendant-Appellee.

Eugene W. BELL, Trustee for the liquidation of Joseph Sebag Incorporated ("Bell"); Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation ("Schroeder"),
Plaintiffs-Appellants,

v.

Seymour VIGMAN, et al., Defendants,

and

Robert G. Holmes, Jr.,
Defendant-Appellee.

Nos. 89-55094, 89-55128.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 6, 1990.
Decided Aug. 3, 1990.

In securities fraud action, the United States District Court for the Central District of California, A. Wallace Tashima, J., entered order dismissing 4 of 75 defendants on ground that court lacked personal jurisdiction and that venue was improper. Appeal was taken. The Court of Appeals, 764 F.2d 1309, reversed and remanded. On remand the District Court dismissed Securities Investor

Protection Corporation's (SIPC) securities fraud claims, and SIPC appealed. The Court of Appeals, 803 F.2d 1513, reversed and remanded. Thereafter the District Court granted summary judgment in favor of one defendant and appeal was taken. The Court of Appeals, David R. Thompson, Circuit Judge, held that: (1) SIPC could commence Racketeer Influenced and Corrupt Organizations Act (RICO) suit against former members of brokerage firm which had become defunct, and officers and directors of corporations whose stock had been traded by firm, without being purchaser of any stock, and (2) trial court could not hold as matter of law that there was no causal connection between one of the corporate officers and any loss sustained, while simultaneously holding that fact issue existed as to whether officer was participant in conspiracy to commit stock fraud.

Reversed and remanded.

1. Racketeer Influenced and Corrupt Organizations 57

Standing limitation that applies to § 10b-5 security action, that plaintiff be purchaser or seller of securities, does not apply to Racketeer Influenced and Corrupt Organizations Act claims based upon predicate acts that are alleged to be securities fraud under Securities Exchange Act and rule 10b-5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 18 U.S.C.A. §§ 1961-1968.

2. Racketeer Influenced and Corrupt Organizations 57

Securities Investor Protection Corporation (SIPC) had standing to bring Racketeer Influenced and Corrupt Organizations Act suit against former members of brokerage firm and executives of corporation whose stock was sold by firm, based upon predicate alleged violation of

securities fraud under Rule 10b-5, even though SIPC was not purchaser of any stocks in question. 18 U.S.C.A. §§ 1961-1968; Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Securities Investor Protection Act of 1970, §§ 3(b)(1), 5, as amended, 15 U.S.C.A. §§ 78ccc(b)(1), 78eee.

3. Racketeer Influenced and Corrupt Organizations 62

While Securities Investor Protection Corporation and the trustee for defunct securities brokerage firm bringing Racketeer Influenced and Corrupt Organizations Act claims against former members of the firm and officers of corporation whose stock was traded by firm, alleging securities fraud as predicate offense, must establish causal connection between alleged fraud and losses they seek to recover, they need only satisfy requirements of proximate cause as understood in typical tort claim. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78(b); 18 U.S.C.A. §§ 1961-1968.

4. Racketeer Influenced and Corrupt Organizations 80

Trial court erred by holding that as a matter of law officer of corporation whose stock was traded by defunct securities brokerage firm had not caused losses sought to be recouped by Securities Investor Protection Corporation and firm's trustee, on grounds that supervening acts of other parties excused officer from liability as to particular alleged acts of securities fraud, and that officer was not legally responsible for acts attributable to others; court had also found that triable issues of fact existed on question whether officer had participated in conspiracy to commit stock fraud, and if he was found to be conspirator, he would be legally responsible for such injuries regardless of whether he had participated in every detail of

conspiracy. 18 U.S.C.A. §§ 1961-1968; Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Federal Civil Procedure 2546

Trial court did not erroneously base its conclusion that genuine issues of material fact existed as to participant of corporate officer in alleged conspiracy to violate Racketeer Influenced and Corrupt Organizations Act (RICO) by committing predicate acts of securities fraud, on basis of expert testimony which included references to documents not attached to or identified in witnesses' declarations; under wide latitude on evidentiary decisions, trial court could rely upon experts' opinion testimony without being limited to statements in declarations. Fed.Rules Evid. Rules 703, 705, 28 U.S.C.A.

6. Federal Civil Procedure 2546

Trial court did not improperly base decision that material issues of fact existed as to whether corporate officer had participated in conspiracy to violate Racketeer Influenced and Corrupt Organizations Act (RICO) by basing determination on expert testimony which included opinion as to ultimate issues of fact; district court had discretion to accept such testimony. Fed.Rules Evid. Rules 702, 704, 28 U.S.C.A.

7. Federal Civil Procedure 2546

Officer of corporation sued by Securities Investor Protection Corporation (SIPC) and trustee of defunct brokerage house, in connection with Racketeer Influenced and Corrupt Organizations Act case having securities fraud predicate, was precluded from challenging under Rule 56 district court's consideration of SIPC and trustee's "statement of background and facts" on grounds

that it was full of unsupported allegations; Rule 56 only governed affidavits and challenged statement was only a guide to evidence. Fed.Rules Civ.Proc. Rule 56(e), 28 U.S.C.A.

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Appeal from the United States District Court for the Central District of California.

Before SCHROEDER, THOMPSON and TROTT, Circuit Judges.

DAVID R. THOMPSON, Circuit Judge:

The district court granted summary judgment in favor of defendant Holmes in this suit brought by the Securities Investor Protection Corporation ("the SIPC") and trustees of defunct stock brokerage firms. The SIPC and the trustees sued to recover losses allegedly sustained as a result of a conspiracy to manipulate the prices of stocks of publicly traded corporations. The district court concluded that the SIPC did not have standing to assert a claim under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO"), when that claim was based on alleged securities violations under

section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[1] The district court also determined that the defendant Holmes' acts viewed separately from those of the other alleged coconspirators were not the proximate cause of the losses sustained. We have jurisdiction under Fed.R.Civ.P. 54(b) and 28 U.S.C. § 1291 and we reverse.

FACTS

In 1970, Congress established the SIPC pursuant to the Securities Investor Protection Act, codified as amended at 15 U.S.C. § 78aaa-78*lll*. The SIPC was created in the wake of the collapse of numerous brokerage houses. It was created to provide greater protection to customers of brokers and dealers and members of national securities exchanges.

The SIPC is a nonprofit corporation. Its membership consists of most registered brokers and dealers. 15 U.S.C. § 78ccc(a). It has the power "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any State, Federal, or other court." 15 U.S.C. § 78ccc(b)(1). The SIPC also has the power to apply for a protective decree from a court of competent jurisdiction and to seek the appointment of a trustee for the liquidation of a broker-dealer member's business when a broker-dealer member fails or is in danger of failing to meet obligations to customers. 15 U.S.C. § 78eee.

In late July 1981, the SIPC instituted liquidation proceedings against two securities brokerages, First State Securities Corp. ("FSSC") and Joseph Sebag, Inc. ("Sebag"). John L. Britton was appointed trustee for the

[1] Section 10(b), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5.

liquidation of FSSC,[2] and Eugene W. Bell was appointed trustee for the liquidation of Sebag (collectively, "the trustees"). In the process of liquidating the brokerages, the SIPC alleges it had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

In July 1983, the SIPC and the trustees filed an action in federal district court against seventy-five defendants, alleging securities fraud in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; a conspiracy under RICO; common law fraud; and breach of fiduciary duty. The SIPC and the trustees alleged in their complaint that from 1964 through July 1981 the defendants engaged in a scheme to manipulate the stock of six companies traded in the over-the-counter market,[3] and that the defendants used FSSC and Sebag as vehicles in the furtherance of this scheme. The defendants are officers and directors of the six companies and former principals and employees of FSSC and Sebag.

The SIPC and the trustees allege that the defendants misrepresented the six companies' prospects through statements by company officials, press releases, and financial statements. An illusion of active markets in the six stocks was allegedly maintained by misleading transactions in the defendants' accounts, in the brokerages' proprietary accounts, and in the accounts of unsuspecting customers. When the alleged scheme was uncovered, the prices of the stocks fell drastically. Because FSSC and

[2] Laurence A. Schroeder is currently the successor trustee for the liquidation of FSSC.

[3] The companies are Aero Systems, Inc., Aerosonics Corp., Bunnington Corp., Creditbank, Inc., Dash Industries, Inc., and Osrow Products Corp.

Sebag held large amounts of the stocks in their proprietary accounts, they incurred heavy losses, leading to the liquidation proceedings.

The present appeal is the third to reach this court in this litigation. In *Securities Investor Protection Corp. v. Vigman*, 764 F.2d 1309 (9th Cir.1985), the district court dismissed four defendants for lack of personal jurisdiction and improper venue. As to lack of personal jurisdiction, we reversed the dismissal of one defendant and remanded the dismissal of another for further consideration. *Id.* at 1316. We also remanded for further proceedings the district court's dismissal of these two defendants on the ground of improper venue. *Id.* at 1318. In *Securities Investor Protection Corp. v. Vigman*, 803 F.2d 1513, 1519-20 (9th Cir.1986), we reversed the dismissal of the SIPC's 10-b5 claims.

Robert G. Holmes, Jr., the only defendant involved in this appeal, is the founder, the chief executive officer, the president, and a major shareholder of Aero Systems, Inc. ("Aero"), one of the six companies whose stock was allegedly manipulated. Holmes also was a shareholder in Bunnington Corp. ("Bunnington"), another one of the six companies, during the period of the alleged manipulation. The SIPC and the trustees allege that Holmes participated in a conspiracy with certain other defendants to manipulate the price of Aero and Bunnington stock. They allege that Holmes issued false and misleading press releases and other public statements regarding a new product Aero was marketing to inflate artificially the price of Aero's stock. Further, they assert that Holmes helped other defendants manipulate the price of Bunnington's stock by purchasing large blocks of Bunnington stock and then selling in small lots, thus creating the appearance of an active trading market. Finally, the

plaintiffs allege that Holmes helped conceal FSSC's poor financial position by allowing FSSC to "park"[4] shares of Bunnington stock in Holmes' trading account.

Holmes moved for summary judgment, asserting that the SIPC lacked standing to assert a RICO claim because the SIPC was not a purchaser or seller of securities. Holmes also contended that any conduct he engaged in did not cause the losses which the SIPC and the trustees sustained.

The district court granted Holmes' motion for summary judgment. The district court concluded that genuine issues of material fact existed as to the elements of the RICO claim, including whether Holmes conspired to violate RICO, but it concluded that the SIPC did not meet the purchaser-seller requirement for standing to assert a RICO claim predicated upon violations of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

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[4] "Parking" is a mechanism used to evade the net capital requirements of the National Association of Securities Dealers ("NASD"). When a brokerage firm files the required monthly report with the NASD regarding its net capital condition, it must discount in value any stock it holds in its own account (referred to as a "haircut"). To reach technical compliance with its net capital requirements, a brokerage firm "sells" stock from the brokerage's own account to a customer at market price. This avoids the discount for reporting purposes. Once the brokerage firm has filed its report with the NASD and met its net capital requirement, the firm "buys" the shares back from the customer, usually at the same price at which it sold the stock plus interest.

The SIPC and the trustees allege that Holmes conspired with FSSC to park shares of Bunnington in Holmes' account to allow FSSC to mask net capital deficiencies in its reports to the NASD. This allegedly allowed FSSC to continue its participation in the overall manipulation conspiracy.

The district court also concluded that a genuine issue of material fact existed as to whether Holmes' acts, upon which the RICO claim was based, were the *actual cause* of the losses to the SIPC and the trustees, but that there was no genuine issue for trial to dispute the fact that Holmes' acts were not the *proximate cause* of the losses. The district court reached its proximate cause conclusion by isolating Holmes' acts from the acts of other members of the alleged conspiracy, and by applying a "loss causation" requirement to the RICO claim.

DISCUSSION

This court reviews de novo a grant of summary judgment, viewing the evidence in the light most favorable to the party against whom it was granted. *Franklin v. Murphy,* 745 F.2d 1221, 1235 (9th Cir.1984). Summary judgment is proper if "there is no genuine issue as to any material fact and ... the moving party is entitled to a judgment as a matter of law." Fed.R. Civ.P. 56(c). Entry of summary judgment is mandated "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986).

A. *Purchaser-Seller Standing Limitation*

[1, 2] The SIPC argues that it need not have been a purchaser or seller of securities to have standing to bring a RICO claim based on predicate acts of securities fraud.[5] The SIPC urges us not to apply to its RICO claim the

[5]Holmes does not challenge the trustees' standing to bring a RICO claim. He challenges only the SIPC's standing to bring such a claim.

purchaser-seller standing limitation applicable to a Rule 10b-5 claim. *See Birnbaum v. Newport Steel Corp.,* 193 F.2d 461, 463-64 (2d Cir.), *cert. denied,* 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952).

In *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), a 10b-5 case, the Supreme Court adopted the *Birnbaum* rule. It held that, to bring a Rule 10b-5 private damages action, a plaintiff must be a purchaser or seller of securities. *Blue Chip Stamps,* 421 U.S. at 754-55, 95 S.Ct. at 1334-35. In a previous appeal in this litigation, we held that the SIPC has standing to assert Rule 10b-5 claims to the extent it can show FSSC and Sebag used customer assets without authorization to purchase or sell securities. *Securities Investor Protection Corp. v. Vigman,* 803 F.2d at 1519.

To determine whether the purchaser-seller standing limitation of a 10b-5 claim also applies to a RICO claim when the RICO claim is based on acts of securities fraud, we first look to RICO's text (*see United States v. Turkette,* 452 U.S. 576, 580, 101 S.Ct. 2524, 2527, 69 L.Ed.2d 246 (1981) and compare that text to Rule 10b-5.

Section 1962(a) of RICO provides:

> It shall be unlawful for any person who has received any income derived ... from a pattern of racketeering activity ... to use or invest ... any part of such income ... in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

18 U.S.C. § 1962(a). "Racketeering activity" includes acts of "fraud in the sale of securities" and of mail fraud

and wire fraud. 18 U.S.C. § 1961(1). Section 1964 provides:

> Any person injured in his business or property by reason of a violation of section 1962 ... may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains....

18 U.S.C. § 1964(c).

On its face, the RICO statute has no purchaser-seller standing requirement. Any plaintiff who is injured "by reason of" fraud in the sale of securities may sue. *See Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir.1987). Thus, even though the predicate acts of a RICO claim may be based on allegations of fraud in the sale of securities, the RICO text does not require a plaintiff to be a purchaser or seller, so long as the plaintiff suffered injury "by reason of" the alleged fraud. In contrast, for conduct to be unlawful under Rule 10b-5, it must have occurred "in connection with the purchase or sale of any security." Rule 10b-5, 17 C.F.R. § 240.10b-5.

In addition to this textual difference between RICO and Rule 10b-5, the source of the civil remedy for violations of the two are different. RICO contains its own express civil action remedy. Neither section 10(b) of the Securities Exchange Act of 1934 nor Rule 10b-5 contains an express civil remedy for a securities fraud violation. That remedy has been implied by the courts. *See Blue Chip Stamps*, 421 U.S. at 730, 95 S.Ct. at 1922 (citing *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n. 9, 92 S.Ct. 165, 169 n. 9, 30 L.Ed.2d 128 (1971), and *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 150-54, 92 S.Ct. 1456, 1470-72, 31 L.Ed.2d 741 (1972)). The remedy of a private civil action under Rule 10b-5

having been court created, the Court has not been reluctant to limit the class of plaintiffs who may bring such a private action. *Blue Chip Stamps*, 421 U.S. at 749, 95 S.Ct. at 1931. And it has limited that class to purchasers or sellers of securities. *Id.* at 730-31, 95 S.Ct. at 1922-23.

With regard to the RICO statute, however, the private civil action for violation of it was not created by the courts, but by Congress in enacting the statute. The RICO statute contains no limitation that a plaintiff must be a purchaser or seller of a security, and it is not appropriate for this court to impose such a limitation. *Cf. Blue Chip Stamps*, 421 U.S. at 748-49, 95 S.Ct. at 1930-31 ("[I]f Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability.") And, as the Supreme Court has stated,

> RICO is to be read broadly. This is the lesson not only of Congress' self-consciously expansive language and overall approach, but also of its express admonition that RICO is to "be liberally construed to effectuate its remedial purposes."

Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497-98, 105 S.Ct. 3275, 3285-86, 87 L.Ed.2d 346 (1985) (citation omitted) (quoting RICO, Pub.L. No. 91-452, § 904(a), 94 Stat. 947).

We hold that the purchaser or seller standing limitation that applies to 10b-5 actions does not apply to RICO claims based upon predicate acts that are alleged to be securities fraud under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated there-

under. Accordingly, the SIPC has standing to assert its RICO claim. We now consider the district court's ruling on causation.

B. *Causation*

[3] The district court determined that in order for the SIPC and the trustees to succeed on their RICO claim against Holmes, they had to show that Holmes' acts were the proximate cause of the harm they suffered. In analyzing this causation question, the district court determined that proximate cause had not been established because the SIPC and the trustees had failed to show "loss causation" to connect Holmes' acts to the losses sustained.

We defined "loss causation" in the context of Rule 10b-5 in *Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 (9th Cir.1984). There we said that "in an action brought under Rule 10b-5 for material omissions or misstatements, the plaintiff must prove both transaction causation, that the violations in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm." *Id.* Having stated the "loss causation" requirement as it pertains to a Rule 10b-5 case, we then went on to hold in *Hatrock* that the plaintiffs did not have to establish "loss causation" because their claim was predicated upon allegations that the defendant broker churned securities in their account to generate commissions. *Id.* at 773-74. Thus, although the plaintiffs still had to prove a causal connection between the defendant's acts and their losses, the trial court had not erred in failing to instruct the jury on "loss causation." *Id.* at 774 & n. 5.

In *Hatrock,* we cited *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir.1974), *cert. denied,* 421

U.S. 976, 95 S.Ct. 1976, 44 L.Ed.2d 467 (1975), as the source of our definitions of "loss causation" and "transaction causation." *Schlick* was

> not a case where the 10b-5 claim [was] based solely upon material omissions or misstatements in the proxy materials. Were it so, concededly there would have to be a showing of both *loss causation* — that the misrepresentations or omissions caused the economic harm — and *transaction causation* — that the violations in question caused the appellant to engage in the transaction in question. The former is demonstrated rather easily by proof of some form of economic damage, here the unfair exchange ratio, which arguably would have been fairer had the basis for valuation been disclosed. Transaction causation requires substantially more. In a misrepresentation case, to show transaction causation a plaintiff must demonstrate that he relied on the misrepresentations in question when he entered into the transaction which caused him harm.

Id. (footnote omitted). The *Schlick* Court pointed out that the 10b-5 claim before it was based upon allegations "of a scheme to defraud which includes market manipulation and a merger on preferential terms, of which the proxy omissions and misrepresentations were only one aspect. Thus appellant need only show loss causation [and not transaction causation as well] with respect to his claim for relief under 10b-5." *Id.* at 381 (footnote omitted).

We turn now to the question whether the SIPC and the trustees must show "loss causation" to support their RICO claim, a claim which is based on predicate acts of securities fraud under the Securities Exchange Act of 1934 and Rule 10b-5. Given the analysis in *Hatrock* and

Schlick, it would appear that they do. But this does not mean that "loss causation" is some additional requirement which must be shown over and above "proximate cause." Rather, "loss causation" is simply a label used to describe the standard rule of tort law that a plaintiff must allege and prove a sufficient causal connection between the defendant's wrongdoing and the plaintiff's harm. *See Bastian v. Petren Resources Corp.,* 892 F.2d 680, 686 (7th Cir.), *cert. denied,* —U.S.—, 110 S.Ct. 2590, 110 L.Ed.2d 270 (1990) ("'loss causation' is an exotic name — perhaps an unhappy one,[6] ... for the standard rule of tort law that the plaintiff must allege and prove that, but for the defendant's wrongdoing, the plaintiff would not have incurred the harm of which he complains."). *Id.* at 685.

We conclude that the SIPC and the trustees must establish a causal connection between the alleged predicate acts of securities fraud and the losses they seek to recover. But in doing so, they need satisfy only the requirements of proximate cause as understood in a typical tort claim. *See Bastian,* 892 F.2d at 680, 683

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[6] As with the term "loss causation," there also appears to be a lack of universal happiness with the term "proximate cause."

> "Proximate cause" — in itself an unfortunate term — is merely the limitation which the courts have placed upon the actor's responsibility for the consequences of the actor's conduct. In a philosophical sense, the consequences of an act go forward to eternity, and the causes of an event go back to the dawn of human events, and beyond. But any attempt to impose responsibility upon such a basis would result in infinite liability for all wrongful acts, and would "set society on edge and fill the courts with endless litigation."

Prosser and Keeton on Torts § 41 at 264 (5th ed.1984) (quoting Mitchell, J., in *North v. Johnson,* 58 Minn. 242, 59 N.W. 1012 (1984)).

("Indeed what securities lawyers call 'loss causation' *is* the standard common law fraud rule (on which see Prosser and Keeton on the Law of Torts § 110, at p. 767 (5th ed.1984)), merely borrowed for use in federal securities fraud cases.").

[4] In the present case, the district court determined that the SIPC and the trustees did not show a sufficient causal connection between Holmes' acts and the losses they sought to recover. Summary judgment was granted in favor of Holmes on this basis. However, the district court also concluded that there was a genuine issue for trial as to whether Holmes participated in a conspiracy to manipulate the shares of the subject companies. Given this conclusion, the SIPC and the trustees, and the Securities and Exchange Commission in an amicus brief, argue that it was error for the district court to examine Holmes' conduct in isolation from the conduct of his coconspirators. We agree.

"All conspirators are liable for the acts of their coconspirators." *Beltz Travel Serv. v. International Air Transp. Ass'n,* 620 F.2d 1360, 1367 (9th Cir.1980). "[A] conspiracy is not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole." *United States v. Patten,* 226 U.S. 525, 544, 33 S.Ct. 141, 145, 57 L.Ed. 333 (1913).

"Dismembering" the conspiracy seems to be what the district court did. In its conclusions of law, the district court stated:

> 3. The actions of Joe Lugo ("Lugo") [the chief financial officer of FSSC and an alleged coconspirator] constituted supervening events which interrupted any alleged causal chain between Holmes' conduct and FSSC's net capital deficiency.

4. The actions of Rodger Garrity and other Sebag brokers constituted supervening events which interrupted any alleged causal chain between Holmes' conduct and Sebag's net capital deficiency.

5. Plaintiffs' losses were caused by the actions of Lugo and the Sebag brokers.

10. Holmes is not legally responsible for Lugo's decision to not repay Nettie Vigman [an alleged coconspirator] from the monies earned from the resale of her shares of Aero Systems to other brokers, and for his subsequent decision to borrow money instead of to sell inventory to repay her.

11. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to pledge Aero Systems stock as collateral for loans.

12. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to use funds they allegedly earned from selling Aero Systems stock for improper purposes.

If Holmes conspired with these codefendants, and if the codefendants caused the alleged injuries, then Holmes is legally responsible. He need not have participated in every detail of the conspiracy. *See Beltz,* 620 F.2d at 1367. Thus, if the district court properly concluded that there was a genuine issue as to whether Holmes conspired to violate RICO, the district court erred in granting Holmes' motion for summary judgment based on a conclusion that his conduct alone did not proximately cause the injuries alleged.

[5, 6] In an attempt to avoid this result, Holmes argues the district court erred in determining that a genuine issue of material fact existed as to whether he participated in a conspiracy to violate RICO. The district court

based its determination on the declarations of two experts and a summary of the evidence contained in a "statement of background and facts" detailing how Holmes allegedly conspired with Lugo, Seymour Vigman [an officer, a shareholder, and the executive committee chairman of Bunnington], and others to manipulate the stock prices of Aero and Bunnington.

Holmes contends that the experts' declarations refer to documents not attached to or identified in the declarations. He also argues that the declarations contain the experts' opinions and conclusions regarding ultimate issues of fact and legal principles.

The district court's decision to consider the experts' declarations was an evidentiary decision. Evidentiary decisions are reviewed for abuse of discretion. *Kisor v. Johns-Manville Corp.,* 783 F.2d 1337, 1340 (9th Cir.1986). A district court has broad discretion in admitting expert testimony, and its decision will be sustained unless it is manifestly erroneous. *Taylor v. Burlington N. R.R.,* 787 F.2d 1309, 1315 (9th Cir.1986).

The Federal Rules of Evidence permit experts wide latitude in the scope and substance of their testimony. Rules 702 and 704 allow an expert to testify in the form of an opinion, even if it is on an ultimate issue of fact, if the expert's specialized knowledge may assist the trier of fact. Rule 703 allows an expert to base an opinion on facts made known to the expert before or at the hearing, and the facts need not be admissible in evidence so long as they are the type reasonably relied upon by experts in the field. Rule 705 permits an expert to give opinion testimony without prior disclosure of the underlying facts, unless the court requires otherwise.

Here, Holmes makes no argument that the experts do not have the specialized knowledge of the securities industry necessary to assist the trier of fact. *Cf. Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525, 530 (9th Cir.1986) (introduction of expert testimony is essential to assist the jury in a churning case). Holmes claims that the two experts included opinions as to ultimate issues of fact, but does not claim that the experts failed to explain how they arrived at these conclusions. *Cf. Bieghler v. Kleppe*, 633 F.2d 531, 533 (9th Cir.1980) (expert's affidavit gave more than a bare conclusion that defendants had been negligent and that this negligence caused the accident). Further, an expert is not required to disclose all of the facts underlying an opinion, including documents the expert has reviewed, unless a court so requires. *See Bulthuis v. Rexall Corp.*, 789 F.2d 1315, 1318 (9th Cir.1985) (per curiam). We conclude that the district court did not abuse its discretion in considering the experts' declarations.

[7] Holmes also challenges under Rule 56(e) the district court's consideration of the SIPC's and the trustees' "statement of background and facts," claiming that it is full of unsupported allegations. However, Rule 56(e) only governs affidavits.[7] The challenged statement consists of a set of allegations that the SIPC and the trustees contend are supported by the declarations of the two

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[7]Rule 56(e) provides:

> Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith.

Fed.R.Civ.P. 56(e).

experts and by a number of exhibits. The statement is not evidence, but instead is a guide to evidence presented to the court to assist it in considering the evidence in opposition to Holmes' motion for summary judgment. As such, the statement is not objectionable under Rule 65(e).

CONCLUSION

We conclude that the district court erred in applying the purchaser-seller standing limitation to the SIPC's RICO claim. We also conclude that the district court erred in granting summary judgment to Holmes because genuine issues exist as to whether Holmes participated in a conspiracy and whether the conspirators caused the harm alleged. The district court did not err in considering the experts' declarations as evidence or in using the statement of background and facts as a guide to the evidence.

We reverse the district court's grant of summary judgment, and remand this case to the district court for further proceedings consistent with this opinion.

REVERSED and REMANDED.

CASE NO. CV 83-4742-AWT (Tx)
[Consolidated Cases]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,
Defendants.

AND CONSOLIDATED ACTIONS.

DEFENDANT ROBERT G. HOLMES, JR.'S STATEMENT OF UNCONTROVERTED FACTS IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT THAT SIPC LACKS STANDING TO ASSERT CLAIMS UNDER 1934 SECURITIES EXCHANGE ACT, SECTION 10(b) AND RULE 10b-5

DATE: October 17, 1988
TIME: : a.m.
PLACE: Courtroom of the
Honorable A. Wallace Tashima

JACK I. SAMET, a Member of, and
STEPHEN K. LUBEGA, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
700 South Flower Street, Suite 700
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Attorneys for Defendant
ROBERT G. HOLMES, JR.

1. In July 1981, the Securities Investor Protection Corporation ("SIPC") commenced the liquidation of Joseph Sebag, Inc. ("Sebag") and First State Securities Corporation ("FSSC") (collectively referred to as the "brokers").

2. SIPC appointed Eugene W. Bell, and John L. Britton (who has since been succeeded by Laurence A. Schroeder) as trustees charged with the duty of liquidating the brokers and returning customer property in accordance with the Securities Investor Protection Act ("SIPA").

3. The trustee for FSSC has admitted that SIPC did not advance any funds to him as trustee to pay for any purchase of Aero Systems ("Aero") stock made prior to July 24, 1981. (Response of Plaintiff Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation ("FSSC's Response") to Defendant Holmes' First Set of Requests For Admissions, ("RFA")) (*See* FSSC's Response to RFA No. 3).

4. The trustee for FSSC admitted that SIPC did not advance any funds to him to compensate any customer in cash for the value of any Aero Systems stocks missing from any customer's account. (FSSC's Response to RFA No. 5).

5. The trustee for FSSC admitted that there were no shares of Aero Systems stock missing from the account of any customer of FSSC as of July 24, 1981. (FSSC's Response to RFA No. 7).

6. The trustee for FSSC has no evidence that SIPC advanced any funds to him to pay for the purchase of any Aero Systems stock missing from any customer's account. (FSSC's Response to RFA No. 4).

7. The trustee for FSSC does not have any evidence that he purchased any Aero Systems stock to satisfy the net equity claim of any FSSC customer. (FSSC's Response to RFA No. 6).

8. The trustee for FSSC does not have any evidence that SIPC advanced funds to him to reimburse any FSSC customer to compensate such customer for the net equity in such customer's account before any alleged unauthorized transactions in Aero Systems, Inc. stock. (FSSC's Response to RFA No. 8).

9. The trustee for Sebag admitted that SIPC did not advance to him any funds to pay for any purchase of Aero Systems stock made prior to July 27, 1981. (Response of Plaintiff Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag ("Sebag's Response") to Holmes First Set of Requests For Admissions ("RFA")). (*See* Sebag's Response to RFA No. 3.).

10. The trustee for Sebag admitted that SIPC did not advance any funds to him for the purchase of any Aero Systems stock missing from any customer's account. (Sebag Response to RFA No. 4).

11. The trustee for Sebag admitted that SIPC did not advance any funds to him in order to compensate any customer of Sebag in cash for the value of Aero Systems stock missing from any customer's account. (Sebag's Response to RFA No. 5).

12. The trustee for Sebag admitted that SIPC did not advance any funds to him for the purchase of any Aero Systems stock allegedly missing from any customer's account.

13. The trustee for Sebag admitted that there were no shares of Aero Systems stock missing from any account of

any customer of Sebag as of July 27, 1981. (Sebag's Response to RFA No. 7).

14. There is no evidence that SIPC advanced funds to the trustee for Sebag to reimburse any Sebag customer for the net equity in such customer's account before any alleged unauthorized transactions in Aero Systems, Inc. stock. (Sebag's Response to RFA No. 8).

15. There is no evidence that Holmes participated in, knew of, approved, or was otherwise involved in any unauthorized transactions by the principals of FSSC and Sebag, Joseph Lugo and Rodger Garrity, and/or their employees, in any security. (Holmes Depo. of 12-4-87, p. 267).

16. In liquidating the estates of the brokers, and administering the payment of brokerage customer claims, the trustee of Sebag took the view that SIPA did not authorize the trustees to compensate customer claims which were a result of fraud. (Letter from Trustee for Sebag to David E. Johns and Virginia D. Johns, dated March 22, 1982, attached as Exhibit "4" to Holmes Motion for Summary Judgment That SIPC Lacks Standing To Assert Claims Under The 1934 Securities Act (the "Standing Motion")).

17. In liquidating the estates of the FSSC and Sebag, the trustees routinely rejected claims by customers who alleged that they were victims of the brokers' fraud. (Exhibit "4" to the Standing Motion, Declaration of John Townley).

18. An example of such a determination by the trustees is a letter from the trustee for Sebag to David and

Virginia Johns dated March 22, 1982 stating, in part, that:

> "Your claim and the material, if any, which accompanied it raises serious questions as to the manner in which your account was handled by the debtor and your investment executive. I have given careful attention to your claim and the matters mentioned therein. However, I must determine your claim in accordance with the applicable provisions of SIPA and the judicial decisions interpreting that statute. Under my view of the law, charges of market manipulation, negligence, fraud or conduct such as that mentioned in your claim, even if true, are not recoverable under the provisions of SIPA or payable from advances by SIPC."

(*See* Exhibit to the Standing Motion).

19. In liquidating the estates of FSSC and Sebag, the trustees for the brokers made many determinations similar to that made in the case of David and Virginia Johns cited herein above. (*See* Exhibit " " to Standing Motion; Declaration of John Townley).

20. The information contained in SIPC's Form 34's prepared by the trustees for Sebag and FSSC in support of proposed distributions to customers and requests to SIPC to advance payments based on, *inter alia*, the calculation of a customer's net equity, indicated no advances from SIPC to the trustees for the purchase of any shares of Aero Systems stock for any customer's account or for the satisfaction of claims on account of missing Aero Systems securities in any customer's account. (Declaration of Stephen McKeand and John Townley and Exhibits " " to the Standing Motion).

CONCLUSIONS OF LAW

1. The implied right of action under Section 10(b) and Rule 10b-5 is available only to a plaintiff who is a purchaser or seller of securities in connection with the alleged securities law violation.

2. SIPC acquires standing as a purchaser/seller to recover on behalf of customers of failed securities brokerage firms only to the extent they are subrogated to the customer's right of recovery under Section 10b and Rule 10b-5.

3. SIPC is mandated by the Securities Investor Protection Act 15 U.S.C. § 78aaa, et seq., SIPA to make cash advances to customers when the failed broker's assets are insufficient to satisfy claims directly arising out of the insolvency and to reimburse customers for their "net equity".

4. SIPC has no standing to assert claims against Holmes under Section 10(b) and Rule 10b-5 of the 1934 Securities Exchange Act because SIPC has not proven that the broker used the customer's assets to make unauthorized purchases or sales of Aero Systems, Inc. securities, and that SIPC advanced cash to customers based upon the net equity of the account before unauthorized transactions.

5. It is insufficient for SIPC to allege that customer losses were caused by fraud or market manipulation in general. SIPC must demonstrate unauthorized transactions of Aero Systems, Inc. stock in the particular customer's account to be subrogated to that customer's rights under the Securities Exchange Act.

6. There is no evidence (SIPC having the burden under *Celotex*) that any pledge of fully-paid-for customer stock was "unauthorized".

DATED: August 12, 1988

Respectfully submitted,

JACK I. SAMET
STEPHEN K. LUBEGA
BUCHALTER, NEMER,
FIELDS & YOUNGER
A Professional Corporation

By _____
Stephen K. Lubega

IT IS SO ORDERED.
Dated: October 25, 1988

_____
A. WALLACE TASHIMA
United States District Judge

CASE NO. CV 83-4742-AWT

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
Plaintiffs,
v.
SEYMOUR VIGMAN, et al.,
Defendants.

[Consolidated Cases CV-83-4724-AWT (TX); CV-83-5674-AWT (Tx); and Bk. No. SA85-0083-PE Adv. No. SA85-0138-PE]

JUDGMENT (PROPOSED)

ORDER OF PARTIAL SUMMARY JUDGMENT

JACK I. SAMET, a Member of
STEPHEN K. LUBEGA, an Associate
BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
700 South Flower Street, Suite 700
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(213) 626-6700

Attorneys for ROBERT G. HOLMES, JR.

The Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment That SIPC Lacks Standing to Assert Claims Under 1934 Securities Exchange Act, Section 10(b) and Rule 10b-5 came on regularly for hearing on October 24, 1988 at 1:30 p.m., before the Honorable A. Wallace Tashima, Judge for the United States District Court, Central District of California. Jack I. Samet, a member of Buchalter, Nemer, Fields & Younger, a Profes-

sional Corporation, appeared on behalf of Defendant Robert G. Holmes, Jr., Stephen Taylor and Robert Graham appeared on behalf of Plaintiffs.

After full consideration of the evidence, the points and authorities submitted by the parties and oral arguments of counsel, the Court finds, for good cause shown, that the Securities Investor Protection Corporation ("SIPC") lacks standing to assert claims under the Securities and Exchange Act of 1934 against Robert G. Holmes, Jr. Accordingly, SIPC's Second and Sixteenth claims for relief against Holmes, based upon Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, are dismissed in their entirety with prejudice.

DATED: October 25, 1988

The Honorable A. Wallace Tashima,
Judge for the United States
District Court

CASE NO. CV 83-4742-AWT (Tx)

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

[Consolidated Cases]
CV-83-4742-AWT (Tx)
CV-83-5674-AWT (Tx)
and Bk. No. SA85-00083-PE;
Adv. No. SA85-0138-PE

STATEMENT OF UNCONTROVERTED FACTS AND CONCLUSIONS OF LAW (MOTION OF DEFENDANT ROBERT G. HOLMES, JR. FOR SUMMARY JUDGMENT ON ISSUE OF CAUSATION FILED CONCURRENTLY HEREWITH)

Date: October 17, 1988
Time:
Place: Courtroom of Honorable
A. Wallace Tashima

JACK I. SAMET, a Member of RICHARD P. WALKER, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER
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Attorneys for Defendant Robert G. Holmes, Jr.

Filed Stamps
August 12, 1988, August 15, 1988 & October 31, 1988
Central District of California Clerk, U.S. District Court

Defendant Robert G. Holmes, Jr. ("Holmes") submits the following Statement of Uncontroverted Facts and Conclusions of Law pursuant to Rule 7.14.1 of the Local Rules of Practice for the United States District Court, Central District of California. The following includes every essential element necessary to entitle Holmes to judgment as a matter of law on all claims brought against him by Plaintiff Securities Investor Protection Corporation ("SIPC") and Plaintiff Trustees in this action, as set forth in the concurrently filed Motion for Summary Judgment on Issue of Causation.

UNCONTROVERTED FACTS

1. On July 21, 1981, First State Securities Corporation ("FSSC") ceased operations for violation of net capital requirements. (NASD Report, October 13, 1981, Exhibit "4" to the concurrently filed Exhibits to Motion of Defendant Robert G. Holmes, Jr. for Summary judgment on Issue of Causation (hereinafter "Exhibit __ hereto"), p. 1, para. 2.)

2. Because of FSSC's net capital deficiency, a trustee designated by SIPC was appointed on July 24, 1981 to liquidate the estate of FSSC, to pay customers of FSSC monies advanced by SIPC, and to perform other functions set forth in the Securities Investor Protection Act of 1970. (NASD Report, October 13, 1981, Exhibit "4" hereto, p. 2, para. 2.)

3. On July 21, 1981, Joseph Sebag, Inc. ("Sebag") ceased operations for violation of net capital rules. (NASD Report, October 16, 1981, Exhibit "5" hereto, p. 3, para. 1.)

4. Due to Sebag's net capital deficiency, a trustee designated by SIPC was appointed on July 27, 1981 to

liquidate the estate of Sebag, to pay customers of Sebag monies advance by SIPC, and to perform other functions pursuant to the Securities Investor Protection Act of 1970. (NASD Report, October 16, 1981, Exhibit "5" hereto, p. 4, para. 4.)

5. Sebag's trustee claims that Sebag's damages are at least $26,212,666.76. (Statement prepared by Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Inc., Exhibit 10,043 to his deposition of September 2, 1987 and Exhibit "8" hereto.)

6. FSSC's trustee claims that FSSC's damages are at least $4,014,433.41. (Calculated from numbers indicated in Final Report of John L. Britton Trustee and in Successor Trustee's First Semi-Annual Report (collectively Exhibit "9" hereto).)

7. FSSC had 33,443 shares of Bunnington Corporation stock in its closing inventory. (NASD Report, October 13, 1981, Exhibit "4" hereto, p. 1, para. 3.)

8. Sebag had 73,640 shares of Bunnington Corporation stock in its closing inventory. (Exhibit 97-G to Foley Deposition and Exhibit "6" hereto.)

9. Bunnington stock dropped in price from $10⅛ per share to $2½ per share within three days after Sebag and FSSC were closed. (NASD Report, October 13, 1981, p. 1, para. 3-p. 2, para. 1.)

10. FSSC had 33,022 shares of Aerosonic Corporation stock in its closing inventory. (NASD Report, October 13, 1981, p. 1, para. 3-p. 2, para. 1.)

11. Sebag had 226,910 shares of Aerosonic Corporation stock in its closing inventory. (Exhibit 97-G to Foley Deposition and Exhibit "6" hereto.)

12. Aerosonic stock dropped in price from $11¼ per share to $5½ per share within three days after FSSC and Sebag were closed. (NASD Report, October 13, 1981, p. 1, para. 3-p. 2, para. 1.)

13. FSSC had no shares of Aero Systems stock in its closing inventory, and was 250 shares short in Aero Systems stock at that time. (Plaintiffs' Responses to Third Set of Interrogatories Propounded By Defendant Robert G. Holmes, Jr., Exhibit "3" hereto (hereinafter "Plaintiffs' Interrogatory Responses"), p. 3, l. 27-p. 4, l. 2.)

14. Sebag had 42 shares of Aero Systems stock in its closing inventory. (Plaintiffs' Interrogatory Responses, p. 4, ls. 13-15.)

15. The price of Aero Systems stock did not drop significantly after FSSC and Sebag were closed. (Memorandum, "Analysis of Firm Inventory [of Sebag] A/O 7-27-81 on the Seven Targeted Securities", Exhibit 97-B to the Foley Deposition and Exhibit "6" hereto.)

16. The National association of Securities Dealers (the "NASD") concluded that the large concentration of Bunnington and Aerosonic stock in FSSC's and Sebag's closing inventories was a substantial cause of the brokerage firms' failure. (NASD Report, October 13, 1981, pp. 1-3; NASD Report, October 16, 1981, pp. 2-4.)

17. On its reports regarding the cause of FSSC's and Sebag's failure, the NASD did not mention Aero Systems. (NASD Report, October 13, 1981; NASD Report, October 16, 1981.)

18. No monies were advanced by SIPC to the Trustees or to the customers of Sebag and FSSC in payment of customer claims with respect to unauthorized transactions by Sebag or FSSC in Aero Systems securities. (*See*

Holmes' concurrently filed Motion for Summary Judgment that SIPC Lacks Standing to Assert Claims Under 1934 Securities Exchange Act and evidence cited therein.)

19. SIPC and the Trustees would not have suffered the losses they are claiming in this action if FSSC and Sebag had complied with net capital requirements. (Foley Deposition, the relevant portions of which are Exhibit "1" hereto, Vol. VIII, p. 874, l. 24-p. 875, l. 2.)

20. FSSC's and Sebag's net capital deficiencies resulted from their undue concentration of Aerosonic and Bunnington stock in their inventories. (Foley Deposition, Vol. VIII, p. 870, ls. 16-20; p. 931, ls. 4-7; NASD Reports, October 13, 1981 (Exhibit "4" hereto) and October 16, 1981 (Exhibit "5" hereto).)

21. FSSC's and Sebag's net capital violations were caused by the brokerage firms' management. (Foley Deposition, Vol. VIII, p. 930, ls. 19-30.)

22. Any alleged manipulation of Aero Systems securities by Holmes or anyone else had no impact on FSSC's or Sebag's net capital deficiencies. (Foley Deposition, Vol. VIII, p. 877, l. 20-p. 878, l. 8.)

23. FSSC had a net capital deficiency by, at the latest, April 1981. (Plaintiff's Interrogatory Responses, Exhibit "3" hereto, p. 6, ls. 19-22.)

24. Plaintiffs claim that Sebag was in a net capital deficiency position by as early as March of 1980, and certainly no later than April of 1981. (Foley Deposition, Vol. VIII, p. 380, ls. 18-22.)

25. Plaintiffs claim that FSSC borrowed money to pay Nettie Vigman for her shares of Aero Systems on April 24

and May 29, 1981. (Plaintiffs' Interrogatory Responses, p. 7, ls. 12-15.)

26. FSSC had sufficient funds available to pay Nettie Vigman on the settlement date when she sold her shares of Aero Systems stock. (Foley Deposition, Vol. III, p. 420, ls. 13-15.)

27. The date FSSC allegedly pledged shares of Aero Systems stock as collateral for a loan was July 15, 1981 (Foley Deposition, Vol. V, p. 642, l. 19), and the date Sebag allegedly pledged Aero Systems stock as collateral was "as of July 27, 1981" (Plaintiffs' Interrogatory Responses, p. 9, l. 21.)

28. The decisions to use Aero Systems stock as collateral for a loan were the decisions of persons at FSSC and Sebag, not of Holmes. (Foley Deposition, Vol. V, p. 646, ls. 11-14 and p. 655, l. 25-p. 656, l. 5.)

29. Holmes never had an account with Sebag, never traded through Sebag, never had any business dealings with Sebag, and never had any relationship with Sebag more than a passing acquaintance with Rodger Garrity. (No evidence of any such connection with Sebag exists in the record.)

30. Sebag never had an undue concentration of Aero Systems stock in its inventory. (Foley Deposition, Vol. III, p. 385, ls. 17-21.)

31. The transaction in which Holmes allegedly parked Bunnington securities occurred after FSSC was in a net capital deficiency position. (Plaintiffs' Interrogatory Responses, p. 8, l. 24; Foley Deposition, Vol. V., P. 579, ls. 14-15.)

32. There is no evidence that Holmes knowingly, willfully or intentionally participated in a "scheme" to con-

trol the floating supply of Bunnington Corporation stock by purchasing the stock in early May of 1981. (Foley Deposition, Vol. VI, p. 718, l.25-p. 720, l. 7.)

33. There is no evidence that Holmes knowingly, willfully, or intentionally assisted FSSC in evading net capital restrictions by "parking" shares of Bunnington Corporation stock in May of 1981. (Deposition of Robert G. Holmes, Jr., May 6, 1988, p. 2820, l. 22-p. 2822, l. 6 and p. 2839, l. 22-p. 2849, l. 25, Exhibit "2" hereto.)

34. The alleged parking transaction did not put FSSC into capital violation. (Foley Deposition, Vol. III, p. 354, ls. 9-11.)

35. The effect of parking is to hide, not cause, a net capital deficiency. (Foley Deposition, Vol. II, p. 185, l. 24-p. 186, l. 15; Vol. V, p. 596, ls. 6-16.)

36. The alleged parking transaction by Holmes was not a cause of FSSC's net capital deficiency. (Foley Deposition, Vol. V, p. 598, ls. 20-23.)

CONCLUSIONS OF LAW

1. Holmes' actions were not the direct, proximate, or legal cause of FSSC's net capital deficiency.

2. Holmes' actions were not the direct, proximate, or legal cause of Sebag's net capital deficiency.

3. The actions of Joe Lugo ("Lugo") constituted supervening events which interrupted any alleged causal chain between Holmes' conduct and FSSC's net capital deficiency.

4. The actions of Rodger Garrity and other Sebag brokers constituted supervening events which interrupted

any alleged causal chain between Holmes' conduct and Sebag's net capital deficiency.

5. Plaintiffs' losses were caused by the actions of Lugo and the Sebag brokers.

6. There is no genuine issue for trial against Holmes on loss causation.

7. FSSC's and Sebag's holdings of Aero Systems stock were not material to the brokerage firms' financial conditions, and did not contribute to their net capital deficiencies.

8. Any alleged manipulation of Aero Systems stock price did not contribute to the net capital deficiencies.

9. Aero Systems was not connected to the net capital deficiencies of FSSC and Sebag.

10. Holmes is not legally responsible for Lugo's decision to not repay Nettie Vigman from the monies earned from the resale of her shares of Aero Systems to other brokers, and for his subsequent decision to borrow money instead of to sell inventory to repay her.

11. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to pledge Aero Systems stock as collateral for loans.

12. Holmes is not legally responsible for the decisions of Lugo and the Sebag brokers to use funds they allegedly earned from selling Aero Systems stock for improper purposes.

13. Events which occurred after FSSC's and Sebag's capital was already impaired and deficient, including all of the events set forth in Plaintiffs' Causation Allegations, did not cause the impairment to happen.

14. A net capital increase cannot be the proximate cause of a net capital deficiency.

15. The direct effect of a manipulation of stock price is to increase net capital.

16. A source of funds is not a direct or proximate cause of the wrongs perpetrated by the user of the funds.

17. To mathematically decrease the floating supply of a stock by purchasing the stock does not render the purchaser a knowing or willing participant in a scheme to control the supply of the stock or to manipulate its price.

18. Holmes did not knowingly, intentionally, or willfully assist FSSC to evade net capital restrictions by his transaction of 5,000 shares of Bunnington Corporation stock in May of 1981.

19. The alleged parking transaction was not material to FSSC's financial position.

20. The alleged parking transaction by Holmes did not cause FSSC's net capital deficiency.

21. A claim that parking enables a brokerge firm to evade net capital restrictions fails to raise a triable issue on loss causation.

22. Holmes is entitled to judgment as a matter of law on all claims brought by Plaintiff Securities Investor Protection Corporation and Plaintiff Trustees.

23. The proximate cause requirement under RICO, *e.g., Haroco v. American Nat'l. Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984), is, in substance, no different than the "loss causation" requirement under the securities laws, when the predicate acts on which the RICO

violation is based is securities fraud. *E.g., Sperber v. Boesky,* 849 F.2d 60 (2d Cir. 1988).

Dated: August 12, 1988

JACK I. SAMET
RICHARD P. WALKER
BUCHALTER, NEMER,
FIELDS & YOUNGER
A Professional Corporation

By _____
RICHARD P. WALKER
Attorneys for Defendant
Robert G. Holmes, Jr.

IT IS SO ORDERED.
Dated: October 28, 1988

_____
A. WALLACE TASHIMA
United States District Judge

CASE NO. CV 83-4742-AWT (Tx)

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

[Consolidated Cases
CV-83-4742-AWT (Tx)
CV-83-5674-AWT (Tx)
and Bk. No. SA85-00083-PE;
Adv. No. SA85-0138-PE]

SUMMARY JUDGMENT (HOLMES)

Date: October 17, 1988
Time:
Place: Courtroom of the Honorable
A. Wallace Tashima

JACK I. SAMET, a Member of
JOVINA R. HARGIS, a Member of
RICHARD P. WALKER, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER
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700 South Flower Street, Suite 700
Los Angeles, California 90017-4183
(213) 626-6700

Attorneys for Defendant Robert G. Holmes, Jr.

Filed Stamps
August 2, 1988 & October 31, 1988
Clerk, U.S. District Court Central District of California

The Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment on Issue of Causation came on regularly for hearing on October ~~17~~ 24, 1988, before the Honorable A. Wallace Tashima, Judge for the United States District Court, Central District of California. Jack I. Samet, a member of Buchalter, Nemer, Fields & Younger, a Professional Corporation, appeared on behalf of Defendant Robert G. Holmes, Jr., and Stephen Taylor and Robert Graham appeared on behalf of Plaintiffs.

After full consideration of the evidence and Points and Authorities submitted by both parties, and oral arguments of counsel, it appears and the Court finds that Defendant Robert G. Holmes, Jr. did not cause the damages alleged by Plaintiffs in this action, that there is no triable issue of any material fact with respect to the requirement of loss causation, and that Holmes is accordingly entitled to judgment as a matter of law.

IT IS HEREBY ORDERED that this Motion for Summary Judgment is granted and judgment shall be entered forthwith as requested in the Motion in favor of Defendant Robert G. Holmes, Jr. and against Plaintiffs.

The Clerk of the Court is hereby ordered to enter this judgment.

Dated: October 28, 1988

Honorable A. Wallace Tashima
United States District Judge

CASE NO. CV 83-4742-AWT (Tx)

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

[Consolidated Cases]

ORDER GRANTING SUMMARY JUDGMENT (RICO CLAIMS)

Date: October 17, 1988
Time: : a.m.
Place: Courtroom of the Honorable A. Wallace Tashima

JACK I. SAMET, a Member of, and
STEPHEN K. LUBEGA, an Associate of
BUCHALTER, NEMER, FIELDS & YOUNGER,
A Professional Corporation
700 South Flower Street, Suite 700
Los Angeles, California 90017-4183
(213) 626-6700

Attorneys for Defendant Robert G. Holmes, Jr.

Filed Stamp
October 31, 1988
Clerk U.S. District Court
Central District of California

The Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment With Respect To Claims Asserted

Under The Racketeer Influenced and Corrupt Organizations Act ("RICO"), came on regularly for hearing on October ~~17~~ 24, 1988 at , before the Honorable A. Wallace Tashima, Judge for the United States District Court, Central District of California. Jack I. Samet, a member of Buchalter, Nemer, Fields & Younger, a Professional Corporation, appeared on behalf of Defendant Robert G. Holmes, Jr., and appeared on behalf of Plaintiffs.

After full consideration of the evidence and the Points and Authorities submitted by the parties, and oral arguments of counsel, it appears and the Court finds, that although there is genuine dispute regarding material facts with respect to the following issues; i.e., whether:

1. There is no identifiable "racketeering enterprise" that is separate and distinct from the alleged pattern of racketeering activity.

2. ~~There is no evidence that~~ Robert G. Holmes, Jr. invested any income derived from a pattern of racketeering activity in an enterprise engaged in interstate commerce.

3. ~~There is no evidence that~~ Robert G. Holmes, Jr. acquired, through a pattern of racketeering activity, an interest in or control of an enterprise.

4. ~~There is no evidence that~~ Robert G. Holmes, Jr. was employed or associated with an enterprise and conducted the affairs of the enterprise through a pattern of racketeering activity.

5. ~~There is no evidence that~~ Robert G. Holmes, Jr. conspired to violate RICO Sections 1962(a); 1962(b); or 1962(c).

6. ~~There is no evidence that~~ the alleged "predicate acts" are offenses involving fraud in the sale of securities or bankruptcy fraud under Title 11, U.S.C., or are indictable as mail or wire fraud under Title 18, U.S.C. §§ 1341, 1343. The alleged "predicate acts" are not therefore "racketeering activity" as defined under RICO Section 1961(1).

7. ~~There is no evidence that~~ at least two "predicate acts" occurring within ten years of each other which meet the criteria of relatedness and continuity to constitute a "pattern" of racketeering activity.

8. The alleged predicate acts did not cause the injuries of the Securities Investor Protection Corporation ("SIPC") and/or the injuries of the Trustees appointed by SIPC to liquidate Joseph Sebag, Inc. and First State Securities Corporation.

However, there is no genuine dispute that:

9. SIPC does not meet the "purchaser-seller" requirements for standing to assert RICO claims which are predicated upon violation of Section 10(b) and Rule 10b-5 of the 1934 federal Securities Exchange Act.*

IT IS HEREBY ORDERED that Defendant G. Holmes, Jr.'s Motion for Summary Judgment With Respect To Claims Asserted Under The Racketeer Influenced and Corrupt Organizations Act is granted and ~~judgment shall be entered forthwith as dismissing~~ such claims ~~requested in Motion~~ are hereby DISMISSED.

~~The clerk of the Court is hereby ordered to enter this judgment.~~

*Note: The grant of summary judgment on "causation" applies also to the RICO claims.

DATED: October 28, 1988

Honorable A. Wallace Tashima
United States District Judge

SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiff-Appellant,
v.
SEYMOUR VIGMAN, et al.,
Defendants-Appellees.
No. 85-5786.
United States Court of Appeals,
Ninth Circuit.
Argued and Submitted April 7, 1986.
Submission Withdrawn July 14, 1986.
Resubmitted November 7, 1986.
Decided November 7, 1986.

In securities fraud action, appeal was taken from order dismissing four of 75 defendants on grounds that court lacked personal jurisdiction and that venue was improper. The Court of Appeals, 764 F.2d 1309, reversed and remanded. On remand, the United States District Court for the Central District of California, A. Wallace Tashima J., dismissed Securities Investor Protection Corporation's securities fraud claims, and SIPC appealed. The Court of Appeals, Eugene A. Wright, Circuit Judge, held that Securities Investor Protection Corporation had standing

to bring securities fraud action against 75 defendants who allegedly engaged in the scheme only if it reimbursed a customer for cash or securities the brokers were supposed to be holding.

Reversed and remanded.

1. Securities Regulation — 185.10

Securities Investor Protection Corporation is a nonprofit corporation created by the Securities Investor Protection Act of 1970; it protects, from broker's financial failure, customers of securities brokers by insuring the net equity of customers' accounts up to specified maxima. Securities Investor Protection Act of 1970, §§ 1(a)-16, 9(a), 16(11), as amended 15 U.S.C.A. §§ 78aaa to 78*lll*, 78fff-3(a), 78*lll*(11).

2. Securities Regulation — 185.13

Under Securities Investors Protection Act, trustee may be appointed to return customer property, complete open transactions, enforce rights of subrogation and liquidate business of brokerage; Securities Investor Protection Corporation is required to advance the trustee necessary funds to complete open transactions and return customer property up to specified maxima. Securities Investor Protection Act of 1970, §§ 5(b)(3), 7, 8, 9(a), 10(c), as amended, 15 U.S.C.A. §§ 78eee(b)(3), 78fff-1, 78fff-2, 78fff-3(a), 78fff-4(c).

3. Securities Regulation — 185.16

If customers of liquidated brokerage could have recovered on Exchange Act securities fraud claim for monies advanced, then Securities Investor Protection Corporation, as subrogee of customers, could do so. Securities Investor Protection Act of 1970, §§ 5(b)(3), 7, 8, 9(a),

10(c), as amended, 15 U.S.C.A. §§ 78eee(b)(3), 78fff-1, 78fff-2, 78fff-3(a), 78fff-4(c).

4. Securities Regulation — 60.15

Securities Investor Protection Corporation did not meet "purchase-or-sale" requirement for standing to bring private securities fraud action following liquidation of two securities brokerages, based on theory that when it paid customers value of missing securities, it constructively purchased them; declining to follow *Rich v. Touche Ross & Co.*, 415 F.Supp. 95 (S.D.N.Y.). Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Securities Regulation — 60.15

Under "aborted seller or purchaser doctrine," if plaintiff had contract to buy or sell a security, contract right will satisfy the *Birnbaum* rule, requiring purchase or sale of a security for standing to bring securities fraud action, even if contract were breached. Securities Act of 1933, § 17(a), 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934, §§ 3(a)(13, 14), 10(b), 15 U.S.C.A. §§ 78c(a)(13, 14), 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

6. Securities Regulation — 60.15, 60.37

Under "pledge doctrine" when stock is pledged as collateral for a loan, pledgor has constructively sold the stock and pledgee constructively bought it, even though no foreclosure has taken place, for purposes of *Birnbaum* rule, requiring purchase or sale of security for standing to bring securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

7. Securities Regulation — 60.15

Under *Birnbaum* rule, requiring purchase or sale of security for standing to bring securities fraud action, there is equivalent of a forced sale whenever shareholder's investment substantially changes in character or when shareholder is forced to accept liquidated value for his shares. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

8. Securities Regulation — 60.15

Securities Investor Protection Corporation, after liquidating two securities brokerages which allegedly failed as result of fraudulent stock market manipulation scheme, did not have standing to bring securities fraud action against defendants who allegedly engaged in the scheme under "aborted seller," "pledge," and "forced sale" doctrines, as exceptions to *Birnbaum* rule, requiring purchase or sale of security for standing to bring securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

9. Securities Regulation — 60.15, 60.37

When broker makes unauthorized purchase or sale of securities with his customer's assets, that purchase or sale may be attributed to the customer for purposes of satisfying the *Birnbaum* rule, requiring purchase or sale of a security for standing to bring securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

10. Securities Regulation — 60.36

Securities Investor Protection Corporation, after liquidating two brokerages which allegedly failed as result of fraudulent stock market manipulation scheme, had standing to bring securities fraud action against 75 defendants who allegedly engaged in the scheme, only if it reimbursed a customer for cash or securities the brokers were supposed to be holding, that is, net equity of customer's account before unauthorized transactions. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Roy G. Wuchitech, Sheppard, Mullin, Richter & Hampton, Los Angeles, Cal., for plaintiff-appellant.

David L. Ross, Greenberg, Traurig, Askew, Hoffman, Lipoff, Rosen & Quentel, P.A., Miami, Fla., for defendants-appellees.

Appeal from the United States District Court for the Central District of California.

Before WRIGHT, NELSON and KOZINSKI, Circuit Judges.

EUGENE A. WRIGHT, Circuit Judge:

Seventy-five defendants allegedly engaged in a fraudulent scheme of stock market manipulation that ultimately caused the failure of two securities brokerages and the loss of many of the brokerage customers' securities and cash. Appellant, Securities Investor Protection Corporation (SIPC), liquidated the brokerages and reimbursed their customers for the value of the cash and securities as of the liquidation.

SIPC sued the brokers and the third-party defendants as subrogee of the brokers' customers and in its own right. It alleged several theories of liability, one being

securities fraud under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) (1982); 17 C.F.R. § 240.10b-5 (1984) (the Exchange Act claims). The court dismissed the Exchange Act claims on the ground that SIPC could not satisfy the purchase-or-sale requirement of an Exchange Act securities fraud claim.

PROCEDURAL BACKGROUND

In July 1981, SIPC instituted liquidation proceedings against two securities brokerages, First State Securities Corporation (FSSC) and Joseph Sebag Incorporated (Sebag) (collectively "the brokerages" or "the brokers"). SIPC brought suit in July 1983, after disbursing the brokerages' assets and reimbursing their customers for the difference between their statutory claims and the brokerage assets. The complaint alleged, among other claims, securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. *See Securities Investor Protection Corporation v. Vigman*, 764 F.2d 1309, 1312 (9th Cir.1985) (previous appeal of this case, reversing and remanding dismissal, based on personal jurisdiction and venue, of two defendants).

The district court consolidated *Cain v. Vigman*, No. CV-83-5674-AWT (C.D.Cal.) with SIPC's action. The *Cain* case is a class action by the brokerages' customers against the defendants. After allowing an amendment to SIPC's complaint, the district court orally granted the defendants' consolidated motion under Fed.R.Civ.P. 12(b)(6) to dismiss SIPC's Exchange Act claims, holding that SIPC lacked standing to assert those claims. The court reasoned that the *Cain* class would "be the more appropriate plaintiff." It entered final judgment on those claims under Fed.R.Civ.P. 54(b).

SIPC appealed. After we heard oral argument and submitted the appeal for decision, we withdrew submission to allow the parties to submit supplemental briefs on several questions that we propounded. The Securities Exchange Commission submitted an amicus brief, which we found helpful. We now order the appeal resubmitted for decision.

FACTS

SIPC alleges that,a from 1964 through July 1981, the defendants engaged in a scheme to inflate the prices for the stocks of six companies. The scheme was carried out by cooperation among the defendants, who were officers and directors of the six companies and principals and employees of the brokerages.

SIPC alleges that the six companies' prospects were misrepresented through statements by company officials, press releases and financial statements. The illusion of active markets in the six stocks was allegedly maintained by misleading transactions in the defendants' accounts, in the brokerage proprietary accounts, and in accounts of unsuspecting customers.

When the scheme was uncovered, the prices of the six stocks fell drastically. Because the defendants had allegedly prostituted the brokerages by loading the proprietary accounts with the stock of the six companies, SIPC placed the brokerages under a protective decree in July 1981. In the process of liquidating the brokerages, SIPC allegedly had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

STANDARD OF REVIEW

This court reviews *de novo* a dismissal for failure to state a claim. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 533 (9th Cir.1984). The dismissal will be affirmed only if it appears beyond doubt that under no set of facts could the plaintiff be entitled to relief. *See Conley v. Gibson,* 355 U.S. 41, 45-46, 78 S.Ct. 99, 101-02, 2 L.Ed.2d 80 (1957); *Simon Oil Co. v. Norman,* 789 F.2d 780, 781 (9th Cir. 1986).

ANALYSIS

A. *Extent of SIPC Subrogation*

In their briefs, the parties argued vigorously over the extent of SIPC's subrogation rights. At oral argument, they seemed to agree on this question. But we set forth briefly the law on this subject to avoid misunderstanding.

[1] SIPC is a nonprofit corporation created by the Securities Investor Protection Act of 1970, as amended, 15 U.S.C. §§ 78aaa-78*lll* (1982) (SIPA). It protects, from a broker's financial failure, the customers of securities brokers by insuring the net equity of customers' accounts up to specified maxima. *See Touche Ross & Co. v. Redington,* 442 U.S. 560, 564-65 n. 5, 99 S.Ct. 2479, 2483, 61 L.Ed.2d 82 (1979).

SIPC is obligated to insure only the value of brokerage customers' "net equity" as of the initiation of the liquidation proceedings. *See* 15 U.S.C. §§ 78fff-3(a), 78*lll*(11) (1982). "Net equity" is a term defined in the Securities Investor Protection Act (SIPA). *See* 15 U.S.C. § 78*lll*(11) (1982). It is the amount that the broker would have owed each customer had it liquidated all the customer's holdings on the date the SIPC filed for a protec-

tive decree, less any outstanding debt the customer owed to the broker. *Id.*

[2, 3] Under SIPA, a trustee may be appointed to return customer property, complete open transactions, enforce rights of subrogation and liquidate the business of the brokerage. 15 U.S.C. §§ 78eee(b)(3), 78fff-1, 78fff-2; *see SIPC v. Barbour,* 421 U.S. 412, 417, 95 S.Ct. 1733, 1737, 44 L.Ed.2d 263 (1975). SIPC is required to advance the trustee necessary funds to complete open transactions and return customer property up to specified maxima. *Barbour,* 421 U.S. at 417, 95 S.Ct. at 1737; *see also Touche Ross & Co. v. Redington,* 442 U.S. 560, 564-65 n. 5, 99 S.Ct. 2479, 2483, 61 L.Ed.2d 82 (1979) (description of SIPC); *SEC v. Securities Northwest, Inc.,* 573 F.2d 622, 624 (9th Cir.1978) (same). To the extent SIPC advances funds, either to the trustee or directly to brokerage customers, it is subrogated to customers' claims. 15 U.S.C. §§ 78fff-3(a), 78fff-4(c). If customers could have recovered on an Exchange Act securities fraud claim for the monies advanced, then SIPC, as subrogee, could do so.

B. *Securities Fraud Claims*

The district court dismissed SIPC's Exchange Act claims because SIPC could not meet the purchase-or-sale requirement for standing to bring a private cause of action under Rule 10b-5.

SIPC asserts that the customers could have stated Exchange Act claims for the losses they would have suffered, had SIPC not reimbursed them. Instead of alleging specific purchases or sales that were tainted by the fraudulent scheme, however, SIPC contends that it may rely on any purchase or sale that was "touched" by fraud, *Superintendent of Insurance v. Bankers Life and*

Casualty Co., 404 U.S. 6, 12-13, 92 S.Ct. 165, 168-69, 30 L.Ed.2d 128 (1971), to support its claims for the missing funds and securities. "The touch test, however, is nothing more than a restatement of the 'in connection with' test." *In re Financial Corp. of America,* 796 F.2d 1126, 1130 (9th Cir.1986).

1. ***Birnbaum** Rule*

[4] In *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), the Court adopted the *Birnbaum* rule, which requires a purchase or sale of a security for standing to sue on an implied cause of action under Section 10(b) of the Exchange Act and Rule 10b-5. *See also Mosher v. Kane,* 784 F.2d 1385, 1388 (9th Cir.1986). Under the *Birnbaum* rule, in order for SIPC to have stated an adequate subrogation claim, the fraud *loss* must be *connected to* the *purchase* or *sale* of a security before the customers were fully aware of the facts and before the deception had ended. *See Shivers v. Amerco,* 670 F.2d 826, 830 (9th Cir.1982) (citing *Ohashi v. Verit Industries,* 536 F.2d 849, 852-53 (9th Cir.), *cert. denied,* 429 U.S. 1004, 97 S.Ct. 538, 50 L.Ed.2d 616 (1976); and *O'Brien v. Continental Illinois National Bank & Trust Co.,* 593 F.2d 54, 58 (7th Cir.1979)).

SIPC's argument, that it may rely on any sale or purchase made by customers during the time of the alleged fraudulent activity, does not persuade us. The fraud that it alleges must be casually related to the claims to which it is subrogated. *See Hatrock v. Edward D. Jones & Co.,* 750 F.2d 767, 773 (9th Cir.1984). Furthermore, it is not enough to say merely that the fraud caused the liquidation of the brokerage firm. *See In re Financial Corp. of America,* 796 F.2d at 1130 (discussing the causation element of the "in connection with" requirement).

The liquidation could have resulted in no subrogation at all had the customers' net equity claims been met by brokerage assets.[1]

[1]Without more, had the brokerages held every share of stock they should have, there would have been no subrogation link to *securities* at all, regardless of how much cash was missing or how little the shares of the stock were worth. SIPC is required to reimburse customers for the value of the securities "as of the close of business on the filing date." 15 U.S.C. § 78fff-2(c)(1). In reimbursing customers for their securities, it has the option of delivering the named securities, or securities of the same description. *See SEC v. Alberl & Maguire Securities Co.*, 560 F.2d 569, 573 (3d Cir.1977); *Rich v. Touche Ross & Co.*, 415 F.Supp. 95, 99-100 (S.D.N.Y.1976); *SEC v. S.J. Salmon & Co.*, 375 F.Supp. 867, 870-71 (S.D.N.Y.1974).

SIPC's allegations show a fraudulent market manipulation scheme which, if true, might support securities fraud recoveries for those in the class action who bought stock at inflated prices and held either the stock or a net equity claim for it when prices fell.

For example, if a broker used fraudulent means to convince a customer to purchase a stock and the customer left that stock with the broker, who subsequently became insolvent, SIPC would be required by SIPA only to return the stock to the customer. 15 U.S.C. § 78fff-2(c)(2); *see also In re June S. Jones Co.*, 52 B.R. 810 (D.Or.1985). The customer would retain any securities fraud claim against the broker for inducing the purchase.

If the stock in question were missing from the broker's inventory of stocks, SIPC could return to the customer the value of the stock as of the date of filing a protective decree, 15 U.S.C. § 78fff-2(b), or, if it could purchase the stock in an orderly market, SIPC could deliver other shares of the same class in the same company to satisfy the customer's claim, 15 U.S.C. § 78fff-2(d). Here too, the customer would retain any securities fraud claim against the broker for inducing the original purchase. SIPC would be entitled to assert a claim, though not necessarily a securities fraud claim, against the broker for the missing stock.

The importance of the proper allocation of claims is evident by the consolidated class action pending before the district court, in which

SIPC contends that when it paid customers the value of missing securities, it constructively purchased them, and may now sue in its own right as purchaser. *See Rich v. Touche Ross & Co.*, 415 F.Supp. 95, 99-100 (S.D.N.Y.1976) (holding that "SIPC liquidation qualifies as a sale" with respect to the customer, "where and to the extent customers' claims to specific shares are satisfied in cash"). We decline to accept this argument. Contrary to the holding in *Rich*, the SIPC liquidation did not "convert" securities into cash, as the securities had disappeared before liquidation. SIPC never received securities for its "purchase price." Garden variety conversion of securities does not become a purchase or sale merely because an insurer has later reimbursed the loss.

To further support its Exchange Act claims, SIPC alleges specific fraudulent transactions by the brokerages. It also contends, under a theory resembling *res ipsa loquitur*, that its payment of nearly $13 million to meet the customers' net equity claims should support an Exchange Act claim. These allegations fail to support a claim under a strict application of the *Birnbaum* rule.

2. *Exceptions to* **Birnbaum** *Rule*

The *Birnbaum* rule has not been applied without flexibility, as the Court recognized in *Bule Chip Stamps*, 421 U.S. at 751, 95 S.Ct. at 1932. *See also In re Financial Corp. of America*, 796 F.2d at 1129 (quoting *Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615, 619 (9th Cir.1981)). Three doctrines that ease the strictures of the *Birnbaum* rule have developed.

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the brokerage customers are pressing claims against the defendants. The class action claims, however, are not before us.

a. *Aborted Seller*

[5] The first is the aborted seller or purchaser doctrine. This proceeds on the strength of § 3(a)(13)-(14) of the Exchange Act, which includes contracts to purchase and contracts to sell within the definitions of "purchase" and "sell." 15 U.S.C. § 78c(a)(13)-(14). *See Ohashi*, 536 F.2d at 853 (quoting *Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339, 345 (9th Cir.1972)). If a plaintiff had a contract to buy or sell a security, the contract right will satisfy the *Birnbaum* rule, even if the contract were breached. *Mosher v. Kane*, 784 F.2d 1385, 1389 n. 5 (9th Cir.1986). *But see Lewelling v. First California Co.*, 564 F.2d 1277, 1279 (9th Cir.1977) (aborted seller does not satisfy *Birnbaum* if plaintiff-seller induced to *retain* securities through defendants' fraud).

b. *Pledge Seller*

[6] The second modification of the *Birnbaum* rule is the pledge doctrine. Under this doctrine, when stock is pledged as collateral for a loan, the pledgor has constructively sold the stock and the pledgee constructively bought it, even though no foreclosure has taken place. *See Rubin v. United States*, 449 U.S. 424, 429-31, 101 S.Ct. 698, 701-02, 66 L.Ed.2d 633 (1981) (pledge is a "sale" for purposes of fraud claim under § 17(a) of Securities Act of 1933); *United States v. Kendrick*, 692 F.2d 1262, 1265 (9th Cir.1982) (pledge of securities constitutes a sale under Rule 10b-5), *cert. denied*, 461 U.S. 914, 103 S.Ct. 1892, 77 L.Ed.2d 282 (1983). *But see In re Financial Corp. of America*, 796 F.2d at 1130 (insufficient that defendant " 'has committed a proscribed act in a transaction of which the pledge of a security is a part' ") (quoting *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir.), *cert. denied*, 469 U.S. 884, 105 S.Ct. 253, 83 L.Ed.2d 190 (1984)).

c. *Forced Seller*

[7] The third doctrine ameliorating the *Birnbaum* rule is the forced seller doctrine which arose in connection with mergers in which a plaintiff alleged fraud in the procurement of the merger. *See Shivers v. Amerco*, 670 F.2d at 830 (discussing *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460 (1967)). After a merger is approved, a stockholder, under most state laws, has two choices: exchange the original stock for the securities and/or cash specified as the purchase price in the merger agreement, or exercise statutory appraisal rights and have the court determine the value of the shares. *See, e.g., Vine*, 374 F.2d at 633-34. In either event, there is the equivalent of a forced sale whenever a shareholder's investment substantially changes its character or when a shareholder is forced to accept a liquidated value for his shares. *See Mosher*, 784 F.2d at 1389.

[8] Without modification, the application of none of these three doctrines is sufficient to overturn the district court's dismissal of SIPC's Exchange Act claims.

SIPC alleges that customers' requests to sell securities were ignored as a part of the defendants' fraudulent scheme. This does not give SIPC standing under the aborted seller doctrine. At most it provides the plaintiff class a claim for breach of the brokers' fiduciary duty. Further, the alleged failure to sell is not causally related to SIPC's net equity losses, because SIPC is required to reimburse customers only for the securities in customers' accounts as of liquidation. Since the securities were never sold, SIPC had only to deliver them.

SIPC alleges that FSSC pledged its customers' securities as collateral for loans to FSSC. In cases that have applied the pledge doctrine the pledgor owned the security. The pledge was a sufficient substitute for sale and purchase. Here, SIPC has alleged that the brokers pledged customers' stock. Thus the pledge doctrine cases are not directly on point.

The forced seller doctrine is probably SIPC's strongest basis for establishing its standing to assert Exchange Act claims. If the Exchange Act provides a remedy in those cases in which "a defendant is engaged in a scheme for the purpose of forcing the plaintiffs to convert their shares for money or other considerations," *Mosher*, 784 F.2d at 1389, arguably it should also provide a remedy where the defendants' scheme results in complete conversion of their shares. *See, e.g., Berner v. Lazzaro*, 730 F.2d 1319, 1322-23 (9th Cir.1984) (discussing purposes of private § 10(b) actions in connection with *in pari delicto* defense) *aff'd sub nom., Eichler v. Berner*, 472 U.S. 299, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985); *Alley v. Miramon*, 614 F.2d 1372, 1386-87 (5th Cir.1980) (approving application of Rule 10b-5 where defendant fraudulently obtained plaintiff's stock and liquidated the corporation). SIPC alleges that it has paid nearly $13 million, including costs and administrative expenses, to satisfy net equity claims. For every security that the brokers were supposed to be but were not holding for customers, the customers had claims for the value of the securities at time of liquidation. *See Rich*, 415 F.Supp. at 99-100.

For essentially the same reason that we rejected SIPC's "constructive purchase" theory, we reject its forced sales theory. The analysis proves too much. Were we to apply the forced seller doctrine to every instance in which SIPC liquidates a brokerage and satisfies customer

claims with cash, we would eliminate the purchase-or-sale requirement. Simple thefts and conversions would become forced sales merely because an insurer reimbursed the loss. The *Birnbaum* rule binds us. Until the Supreme Court repudiates it, we are unable to do so. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-80, 97 S.Ct. 1292, 1302-04, 51 L.Ed.2d 480 (1977).

3. *Valid Claims*

Even though we hold that SIPC has shown, under the established exceptions to the *Birnbaum* rule, no set of facts under which it would be entitled to Exchange Act relief, we are unconvinced that no set of facts could be proven that would entitle it to Exchange Act relief. There are many reasons why the securities that FSSC and Sebag were supposed to be holding could be missing. "[S]ecurities belonging to customers may have been lost, improperly hypothecated, misappropriated, never purchased or even stolen. . . ." S.Rep. No. 95-763, *reprinted in* 1978 U.S. Code Cong. & Ad.News 764, 765. Most of these reasons would not satisfy the purchase-or-sale requirement of *Blue Chip Stamps*.

[9] SIPC has alleged, however, that the defendants made unauthorized transactions in customers' accounts as part of their fraudulent scheme. If so, some of those transactions could satisfy the *Birnbaum* rule. Where a broker abuses his customer's trust through unauthorized transactions, there is no reason why the *Birnbaum* rule should not be applied flexibly. We hold that when a broker makes an unauthorized purchase or sale of securities with his customer's assets, that purchase or sale may be attributed to the customer for purposes of satisfying the *Birn-*

baum rule.[2] *See Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274, 1277 (5th Cir.1986) (unauthorized commodity trades). Allowing an Exchange Act claim for such a transaction implicates none of the concerns before the Court in *Blue Chip Stamps*. *See* 421 U.S. at 737-49, 95 S.Ct. at 1926-31.

[10] Under our holding, the district court erred in dismissing SIPC's Exchange Act claims. Our conclusion applies to SIPC, of course, only if it reimbursed a customer for the cash or securities the brokers were *supposed to be holding*, that is, the net equity of the customer's account before the unauthorized transactions. If the customer's reimbursement were based on the net equity of his or her account as though the transactions were authorized, that is, the net equity of the account after the unauthorized transactions, then the customer, not SIPC, has standing to assert the Exchange Act claim. In that case, SIPC would be relegated to more pedestrian theories, such as conversion, to recover on the claim to which it is subrogated.

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[2]Examples of unauthorized transactions in which the broker's purchase or sale should be attributed to the customer include:

1. Those in which a broker acting as a bailee of his customer's cash, *see Rich*, 415 F.Supp. at 99, uses the funds without authorization to purchase securities;

2. Those in which a broker acting as bailee of his customer's securities sells or pledges the securities without authorization.

In these cases, the purchase or sale made by the broker "passes through" to the customer for purposes of the *Birnbaum* rule. If on remand, however, SIPC can show no more than that the cash or securities are missing and cannot show that the broker engaged in an unauthorized transaction, no purchase or sale has been shown and recovery under section 10(b) or rule 10b-5 is inappropriate.

CONCLUSION

The district court did not err in dismissing SIPC's Exchange Act claims under a strict application of the *Birnbaum* rule. Nor did it err under any of the current doctrines ameliorating the harsh effect of the rule. We hold, however, that a broker's unauthorized purchase or sale of securities using a customer's assets may be attributed to the customer, and through the customer to SIPC, satisfying the purchase-or-sale requirement for an Exchange Act claim. Since a set of facts exists under which SIPC may be entitled to relief, we must allow SIPC an opportunity to prove those facts.

REVERSED and REMANDED.

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND JOHN L. BRITTON, TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

v.

SEYMOUR VIGMAN, et al.,

Defendants,

and

EUGENE C. FERRI, JR., AND MOBILE INTERNATIONAL CORPORATION,

Defendants-Appellees.

Nos. 84-6074, 84-6311.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 8, 1985.

Decided July 2, 1985.

In a securities fraud action, plaintiffs appealed from an order of the United States District Court for the Central District of California, A. Wallace Tashima, J., dismissing four of the 75 defendants on the ground that the court lacked personal jurisdiction and that venue was improper. The Court of Appeals, Barnes, Senior Circuit Judge, held that: (1) section 27 of the Securities Exchange Act authorizes nationwide service of process; (2) so long as a defendant has minimum contacts with the United States, section 27 confers personal jurisdiction over the defendant in any federal district court, and the court in the instant case clearly had personal jurisdiction over the

individual appellee, a United States resident; (3) whether section 27 confers personal jurisdiction over a nonresident defendant depends on whether the defendant has acted within any district of the United States or sufficiently caused foreseeable consequences in this country; and (4) the coconspirator venue theory should be applied to determine venue in an action brought for violations under the Securities Exchange Act where there are numerous defendants, and where there is more than one appropriate forum in which to bring the action.

Reversed and remanded.

1. Federal Courts — 776

Court of Appeals, which reviews de novo the dismissal of a complaint without leave to amend, must determine whether the district court erred as a matter of law.

2. Courts — 489(1)

Jurisdiction to consider claims brought under the Securities Exchange Act of 1934 is vested exclusively in the federal courts. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

3. Securities Regulation — 139

When considering a Section 10(b) and Rule 10b-5 claim for relief, the court should liberally construe that claim in order to effectuate the policies underlying the federal securities laws. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

4. Federal Courts — 3, 71

"Jurisdiction" is the power to adjudicate, while "venue," which relates to the place where judicial author-

ity may be exercised, is intended for the convenience of the litigants.

See publication Words and Phrases for other judicial constructions and definitions.

5. Federal Courts — 71

In order for the district court to hear a case, the court must have not only personal jurisdiction over the parties, but also venue.

6. Federal Courts — 161

General jurisdictional statute which confers the power of the district court to hear a cause arising from a violation of a federal law or statute is the federal question statute. 28 U.S.C.A. § 1331.

7. Federal Courts — 192

A claim based on violation of a federal statute is a claim arising under federal law within the meaning of the federal question statute. 28 U.S.C.A. § 1331.

8. Securities Regulation — 135

Section 27 of the Securities Exchange Act authorizes nationwide service of process. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

9. Constitutional Law — 305(5)

When a federal district court is not sitting in diversity, due process requires that defendant have some "contacts, ties or relations" with the forum state in order to confer, in the district court, personal jurisdiction over defendant; nonetheless, "minimum contacts" with a particular district or state for purposes of personal jurisdiction is not a

limitation imposed on the federal courts in a federal question case by due process concerns. U.S.C.A. Const. Amends. 5, 14.

10. Securities Regulation — 135

Where a federal statute such as section 27 of the Securities Exchange Act confers nationwide service of process, the question becomes whether the party has sufficient contacts with the United States, not any particular state. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

11. Securities Regulation — 133

So long as a defendant has minimum contacts with the United States, section 27 of the Securities Exchange Act confers personal jurisdiction over the defendant in any federal district court, and the district court in the instant case clearly had personal jurisdiction over individual defendant, a United States resident. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

12. Securities Regulation — 133

Whether section 27 of the Securities Exchange Act confers personal jurisdiction over a nonresident defendant depends on whether the defendant has acted within any district of the United States or sufficiently caused foreseeable consequences in this country. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

13. Securities Regulation — 133

Intent of the venue and jurisdiction provisions of the securities laws is to grant potential plaintiffs liberal choice in their selection of a forum, and unless the balance of factors is strongly in favor of defendants,

plaintiff's choice of forum should rarely be disturbed. Securities Exchange Act of 1934, § 27, 15 U.S.C.A § 78aa.

14. Securities Regulation — 133

Coconspirator venue theory — which provides that where venue is established in a district for any defendant in a securities action which is brought against multiple defendants alleging a common scheme, then venue is proper as to all defendants even though certain defendants did not commit an act within the district — should be applied to determine venue in an action brought for violations under the Securities Exchange Act where there are numerous defendants, and where there is more than one appropriate forum in which to bring the action. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

15. Federal Civil Procedure — 201

There is an important interest to be served by joining all defendants in one action, thereby avoiding duplicitous litigation and inconsistent results.

16. Securities Regulation — 133

Under the "co-conspirator venue theory," where an action is brought against multiple defendants alleging a common scheme of acts or transactions in violation of securities statutes, so long as venue is established for any of the defendants in the forum district, venue is proper as to all defendants; and this is true even in the absence of any contact by some of the defendants in the forum district.

See publication Words and Phrases for other judicial constructions and definitions.

17. Securities Regulation — 133

The strong policy favoring litigation of related claims in the same forum supports application of a coconspirator venue theory in actions based upon violations of federal securities statutes.

18. Securities Regulation — 133

Inconvenience of requiring one defendant in a multidefendant federal securities action to litigate in a distant forum is greatly outweighed by the interests of judicial economy and bringing together in one lawsuit all related claims and alternative theories.

19. Federal Courts — 14

Determination of whether to exercise jurisdiction over pendent state claims is within the discretion of the district court, which is not required to exercise such jurisdiction.

Stephen C. Taylor, Sheppard, Mullin, Richter & Hampton, Los Angeles, Cal., for plaintiffs-appellants.

Daniel L. Goelzer, Gen. Counsel, Paul Gonson, Sol., Jacob H. Stillman, Asso. Gen. Counsel, Robert Mills, Sp. Counsel, SEC, Washington, D.C., amicus curiae.

Bill E. Schroeder, Patrick J. Steele, McCutchen, Black, Verleger & Shea, Los Angeles, Cal., for defendants-appellees.

Appeal from the United States District Court for the Central District of California.

Before BARNES, Senior Circuit Judge, REINHARDT, Circuit Judge, and GILLIAM, District Judge.*

BARNES, Senior Circuit Judge:

Appellants, Securities Investor Protection Corporation ("SIPC"), Eugene W. Bell and John L. Britton appeal the dismissal of four of seventy-five defendants from the securities fraud action brought in the United States District Court for the Central District of California. The district court dismissed these defendants, finding that it lacked personal jurisdiction over them, and that venue was improper in the Central District. This appeal presents questions of first impression in this Circuit, and we reverse the district court's dismissal of the defendants.

I. BACKGROUND

Appellant SIPC was established pursuant to the Securities Investors Protection Act of 1970, as amended, 15 U.S.C. § 78aaa, *et seq.*, in response to the collapse of numerous brokerage houses, in order to provide greater protection for customers of registered brokers and dealers and members of national securities exchanges. H.R.Rep. No. 1613, 91st Cong.2d Sess., *reprinted in* 1970 U.S.Code Cong. & Ad.News, 5254, 5254-55. Congress created the SIPC as a private, nonprofit corporation, whose members would consist of most of the broker-dealers registered under the Act. 1970 U.S.Code Cong. & Ad.News at 5258.

The SIPC has the power to sue and be sued, and to complain and defend in its corporate name and through

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* The Honorable Earl B. Gilliam, United States District Judge for the Southern District of California, sitting by designation.

its own counsel, in any State, Federal or other court. 15 U.S.C. § 78ccc(b)(1). In addition, the statute empowers the SIPC to seek a protective decree from a court of competent jurisdiction when one of the broker-dealer members has failed or is in danger of failing to meet its obligations to customers, and to appoint a trustee for the liquidation of the business of the broker-dealer member. *See* 15 U.S.C. § 78eee.

Upon application of the SIPC, on July 24, 1981, John L. Britton ("Britton") was appointed trustee for the liquidation of First State Securities Corporation ("FSSC"), a Delaware corporation with its principal place of business in North Miami, Florida. On July 27, 1981, Eugene W. Bell ("Bell") was appointed trustee for the liquidation of Joseph Sebag Incorporated ("Sebag"), a Delaware securities broker-dealer corporation, registered and licensed by the National Association of Securities Dealers, with its principal place of business in Los Angeles, California. These appointments were made pursuant to the provisions of 15 U.S.C. § 78eee.

This action was filed in the United States District Court for the Central District of California on July 22, 1983 by Appellants SIPC, Bell and Britton under the powers granted by 15 U.S.C. § 78ccc(b)(1). The complaint alleged securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Act") and Rule 10b-5 thereunder; a conspiracy under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* ("RICO"); common law fraud; and breach of fiduciary duty. Appellants alleged in their complaint that the seventy-five defendants engaged in acts which appellants contend to be predatory manipulative schemes practiced upon member broker-dealers of the SIPC and the investing public concerning the stock of

seven companies traded in the over-the-counter market, and that defendants engaged Sebag and FSSC as vehicles in furtherance of their scheme.

All seventy-five defendants in this action have moved the district court to dismiss and/or strike the complaint, basing their motions on various grounds. The district court entered an order dismissing certain of the seventy-five defendants on May 30, 1984, finding that it lacked personal jurisdiction over those defendants and that venue was improper in the Central District of California. On August 20, 1984, the district court amended the order, and dismissed without leave to amend but not on the merits, the complaint as to four of the defendants who are the appellees in this appeal. The claims against appellees were limited to alleged violations of the Act and common law fraud, and did not include any alleged violations under RICO or for breach of fiduciary duty.

Only two of the appellees remain in this appeal: Eugene C. Ferri, Jr. ("Ferri"), a United States citizen, and Mobile International Corporation ("Mobile"), a foreign corporation. The other two appellees, Leo Vela and Harry Drooker were dismissed by orders of this Court, pursuant to stipulations of the parties.

In dismissing the appellees, the district court rejected appellants' argument that Section 27 of the Act (15 U.S.C. § 78aa) allows nationwide service of process and confers personal jurisdiction over the defendants. It also refused to apply a co-conspirator theory of venue. The co-conspirator theory of venue provides that where venue is established in a district for any defendant in a securities action which is brought against multiple defendants alleging a common scheme, then venue is proper as to all defendants even though certain defendants did not commit an act within the district. *See generally,*

Securities and Exchange Commission v. Diversified Industries, 465 F.Supp. 104, 111 (D.D.C.1979) the court certified the May 30, 1984 order and the August 20, 1984 amended order for immediate appeal pursuant to Federal Rules of Civil Procedure 54(b), and appellants filed a timely notice of appeal.

II. ANALYSIS

There are two issues to be resolved by this court:

(1) Whether the district court erred in finding that it lacked personal jurisdiction over certain defendants in an action brought under the Securities Exchange Act of 1934; and

(2) Whether the district court erred when it failed to apply a co-conspirator venue theory to an action under the Securities Exchange Act of 1934.

A. Standard of Review

[1] This Court reviews de novo the dismissal of a complaint without leave to amend. *Whittington v. Whittington,* 733 F.2d 620, 621 (9th Cir.1984). We must determine whether the district court erred as a matter of law. *See e.g., Des Brisay v. Goldenfield Corp.,* 549 F.2d 133, 134 (9th Cir.1977); *Fitzsimmons v. Barton,* 589 F.2d 330, 331 (7th Cir.1979); *Mariash v. Morrill,* 496 F.2d 1138, 1140 (2d Cir.1974).

B. The Act

[2] Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa), grants jurisdiction to the federal courts and provides for venue and service of process. *Touche Ross & Co. v. Redington,* 442 U.S. 560, 577, 99 S.Ct. 2479, 2489, 61 L.Ed.2d 82 (1979). The jurisdiction to

consider claims brought under the Act is vested exclusively in the federal courts. *Clark v. Watchie,* 513 F.2d 994, 997 (9th Cir.), *cert. denied,* 423 U.S. 841, 96 S.Ct. 72, 46 L.Ed.2d 60 (1975).

Appellants argue that (1) Section 27 of the Act (15 U.S.C. § 78aa) provides for nationwide service of process, thereby conferring personal jurisdiction over defendants Ferri and Mobile, and (2) the district court applied a narrower standard for determining venue than that allowed under the Act, and it should have adopted a co-conspirator theory of venue. We agree.

[3] When considering a Section 10(b) and Rule 10b-5 claim for relief, the court should liberally construe that claim in order to effectuate the policies underlying the federal securities laws. *See, e.g., Affiliated Ute Citizens v. United States,* 406 U.S. 128, 150-54, 92 S.Ct. 1456, 1470-72, 31 L.Ed.2d 741 (1972); *Superintendent of Insurance v. Bankers Life and Casualty Co.,* 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971); *Mansbach v. Prescott, Ball and Turben,* 598 F.2d 1017, 1924-25 (6th Cir.1979).

[4, 5] In distinguishing between the principles of jurisdiction and venue, we note that "[j]urisdiction is the *power* to adjudicate, while venue, which relates to the place where judicial authority may be exercised, is intended for the *convenience* of the litigants." *Still v. Rossville Crushed Stone Co.,* 370 F.2d 324, 325 (6th Cir.1966) (per curiam) (emphasis added) (*citing Neirbo Co. v. Bethlehem Shipbuilding Corp.,* 308 U.S. 165, 60 S.Ct. 153, 84 L.Ed. 167 (1939); 1 Barron & Holtzoff, Federal Practice and Procedure (Wright Ed.), § 71), *cert. denied,* 387 U.S. 918, 87 S.Ct. 2030, 18 L.Ed.2d 970 (1967). In order for the district court to hear a case, the court must have not only personal jurisdiction over the parties, but also venue.

C. Personal Jurisdiction

In order to find personal jurisdiction over Appellees Ferri and Mobile in the Central District of California, there must be an applicable rule or statute which potentially confers jurisdiction over the defendants. *See, Amba Marketing Systems, Inc. v. Jobar International, Inc.,* 551 F.2d 784, 787 (9th Cir.1977). In addition, assertion of such jurisdiction must accord with constitutional principles of due process. *Id.* at 787.

[6, 7] The general jurisdictional statute which confers the power of the district court to hear a cause arising from a violation of a federal law or statute is 28 U.S.C. § 1331 (federal question). "A claim based on a violation of a federal statute is a claim arising under federal law within the meaning of 28 U.S.C. § 1331." *Haas v. Wieboldt Stores, Inc.,* 725 F.2d 71, 73 (7th Cir.1984). More specifically, Section 27 of the Act (15 U.S.C. § 78aa) confers federal jurisdiction over claims of violations of federal securities law. *Id.* at 73. *See also, Hilgeman v. National Insurance Co. of America,* 547 F.2d 298, 301 (5th Cir.1977); *Mariash v. Morrill,* 496 F.2d at 1142; *accord, GRM v. Equine Investment and Management,* 596 F.Supp. 307, 311 (S.D. Tex.1984); *Clement v. Pehar,* 575 F.Supp. 436, 438 (N.D.Ga.1983). Section 27 provides that any suit or action to enforce any liability or duty created under the Act may be brought in the district where any act or transaction constituting the violation occurred, and process may be served in any district where the defendant is an inhabitant or wherever the defendant may be found.[1]

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[1]15 U.S.C. § 78aa. *Jurisdiction of Offenses and Suits.*

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations in

In addition, Rule 4(f), Federal Rules of Civil Procedure, sets the territorial limits within which service of process will be effective upon a party.[2] This rule limits the district court's ability to obtain personal jurisdiction over a defendant to jurisdiction in the state within which the district court sits, unless a statute of the United States confers territorial limits beyond the boundaries of that state.

In view of the foregoing, we find that there are rules and statutory authority which support nationwide service under the Act and confer personal jurisdiction in the Central District of California.

Appellees Ferri and Mobile argue that *Leroy v. Great Western United Corp.*, 443 U.S. 173, 99 S.Ct. 2710, 61 L.Ed.2d 464 (1979) controls. We disagree. In *Leroy,* the Court reversed the normal order of considering personal

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this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of Title 28. No costs shall be assessed for or against it in the Supreme Court or other such courts.

[2]Fed.R.Civ.P. 4(f): *Territorial Limits of Effective Service.*

All Process other than a subpoena may be served anywhere within the territorial limits of the state in which the district court is held, and when authorization by statute of the United States or by these rules, beyond the territorial limits of that state . . .

jurisdiction in advance of venue, and found venue to be improper under Section 27 of the Act. However, the Court based its finding of lack of venue on the fact that Section 28(a) of the Act (15 U.S.C. § 78bb(a)) imposed no duty upon out-of-state officials to defined an action in a distant forum. *See Leroy,* 443 U.S. at 181-187, 99 S.Ct. at 2718. The Court went on to hold "§ 27 of the 1934 Act does not provide a basis for personal jurisdiction." *Id.* at 180, 99 S.Ct. at 2715.

The facts in *Leroy* are clearly distinguishable from the facts here. In *Leroy,* Great Western, whose principal place of business was in Texas, announced its intent to make a tender offer for a corporation with its principal place of business and most of its assets located in Idaho. Great Western filed an action in the federal district court in Texas, seeking to invalidate the Idaho takeover statutes as they purported to apply to interstate cash tender offers to purchase securities traded on the national exchange. The defendants in *Leroy* were Idaho state officials, and the Court based its finding of improper venue and lack of personal jurisdiction on Section 28(a) of the Act. The Court stated that "[t]here is nothing in its text or its legislative history to suggest that it imposes any *duty on the States* or that indicates who might enforce any such duty. [Section 28(a)] was plainly *intended to protect, rather to limit, state authority." Id.* at 182, 99 S.Ct. at 2716. (emphasis added).

The defendants in the case before us are private parties and not state officials. Furthermore, the appellants are not challenging the validity of a state statute. SIPC, Bell and Britton brought this action alleging that the private defendants' actions constituted violations of federal securities laws. Because the Court in *Leroy* based its finding of lack of personal jurisdiction on the fact that venue was

improper, the Court's holding with respect to personal jurisdiction does not apply here. "It is simply too late in the day to argue that Section 27 does not authorize nationwide service of process on any individual named in the complaint, provided, of course, the complaint states a claim under the 1934 Act." *Mariash v. Morrill,* 496 F.2d at 1142.

[8] We are persuaded by the holdings of the Second Circuit in *Mariash* and the Seventh Circuit in *Fitzsimmons v. Barton,* 589 F.2d 330 (7th Cir.1979), that Section 27 of the Act (15 U.S.C. § 78aa) authorizes nationwide service of process. However, we must now determine whether this statute, which confers jursidiction over the defendants, accords with constitutional principles of due process. *See Amba Marketing Systems, Inc.,* 551 F.2d at 787.

We address briefly the due process considerations inherent in personal jurisdiction. The Supreme Court in *International Shoe Co. v. Washington,* 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945), set forth the "minimum contacts" doctrine to be applied in determining whether due process will be afforded to defendants where a court asserts *in personam* jurisdiction over them. *See Id.* at 316, 66 S.Ct. at 158. *International Shoe* and its progeny, *Hanson v. Denckla,* 357 U.S. 235, 78 S.Ct. 1228, 2 L.Ed.2d 1283 (1958); *Shaffer v. Heitner,* 433 U.S. 186, 97 S.Ct. 2569, 53 L.Ed.2d 683 (1977); and more recently *Worldwide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980), have required some "contacts, ties or relations" with the forum state in order to confer *in personam* jurisdiction over a defendant. *See Worldwide Volkswagon,* 444 U.S. at 299, 100 S. Ct. at 568.

[9] We note that the line of cases flowing from *International Shoe* deals with a state court's jurisdiction over a non-resident defendant, generally by the use of a state

long-arm statute. When a federal district court is sitting in diversity, we agree that due process requires that the defendant have some "contacts, ties or relations" with the forum state in order to confer, in the district court, personal jurisdiction over the defendant. Nonetheless,

> 'minimum contacts' with a particular district or state for purposes of personal jurisidiction is *not* a limitation imposed on the federal courts in a federal question case by due process concerns. The Constitution does not require the federal distrcts to follow state boundaries .... It is clear that Congress can provide for nationwide service of process in federal court for federal question cases without falling short of the requirements of due process.

Johnson v. Creative Arts & Wool Masters, Inc., 743 F.2d 947, 950 (1st Cir.1984) (citations and footnotes omitted).

[10] Where a federal statute such as Section 27 of the Act confers nationwide service of process, "the question becomes whether the party has sufficient contacts with the United States, not any particular state." *Nelson v. Quimby Island Reclamation District,* 491 F.Supp. 1364, 1378 (N.D.Cal.1980). *See also, FTC v. Jim Walter Corp.,* 651 F.2d 251, 256 (5th Cir.1981) (due process requires only that a defendant in a federal suit have minimum contacts with the United States, the sovereign that created the court); *Fitzsimmons v. Barton,* 589 F.2d at 333 (the defendant, a resident citizen of the United States, had sufficient contacts with the United States to support the fairness of exercise of jurisdiction over him by a United States court); *Mariash v. Morrill,* 496 F.2d at 1143 (where the defendants reside within the territorial boundaries of the United States, the "minimum contacts," required to justify the federal government's exercise of power over them, are present).

[11] We hold, therefore, that so long as a defendant has minimum contacts with the United States, Section 27 of the Act confers personal jurisdiction over the defendant in any federal district court. The district court erred in finding that it lacked personal jurisdiction over Ferri, a United States citizen.

Nevertheless, in *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (9th Cir.1974), this Court held that Congress intended Section 27 to " 'authorize service on a defendant who can be "found" only in a foreign country . . .' " *Id.* at 529 (quoting *Leasco Data Processing Equipment Corp. v. Kerman*, 468 F.2d 1326, 1340 (2d Cir.1974)). The Court subsequently concluded that " 'although the section does not specifically deal with *in personam* jurisdiction, it is reasonable to infer that Congress meant to assert personal jurisdiction over foreigners not present in the United States to but, of course, not beyond the bounds permitted by the due process clause of the Fifth Amendment . . . .' " *Travis*, 473 F.2d at 529 (quoting *Leasco*, 468 F.2d at 1340). The *Travis* court concluded that when service of process had been made outside of the United States, personal jurisdiction could be acquired over "defendants who have acted within the district or sufficiently caused foreseeable consequences there, . . ." *Id.* at 529.

[12] Having concluded that Section 27 authorizes nationwide service of process, and that personal jurisdiction in any district is therefore conferred over resident defendants upon a showing of minimum contacts with the United States, we conclude that due process demands imposition of a similar rule with respect to foreign defendants. Thus, whether Section 27 will confer personal jurisdiction over a non-resident defendant depends on whether the defendant has acted within any district of the United States or sufficiently caused forseeable consequences in this country. *Cf. Travis, supra.*[3] We remand this question in order that the district court may make a determination as to whether the consequences of Mobile's acts within the United States were reasonably forseeable to confer personal jurisdiction over Mobile.

D. Venue

The venue issue is also governed by Section 27 of the Act (15 U.S.C. § 78aa). *Hilgeman v. National Insurance Co. of America*, 547 F.2d at 301. Under Section 27 of the Act, a suit to enforce any liability or duty created under the Act may be brought either (1) in the district wherein the defendant is found or is an inhabitant or transacts business, or (2) in the district wherein any act or transaction constituting the violation occurred. *See* note 2, *supra; see also, Mariash v. Morrill*, 496 F.2d at 1144; *GRM v. Equine Investment and Management Group*, 596 F.Supp. at 311; *Carty v. Health-Chem Corp.*, 567 F.Supp. 1, 2 (E.D.Pa.1982).

Since neither Ferri nor Mobile is found within the Central District of California, and its does not appear

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[3] The district court properly quashed service on Mobile. The court properly applied state procedural law in determining the proper method for service of process pursuant to Federal Rules of Civil Procedure 4(c)(2)(C). Under California Code of Civil Procedure § 416.20, a complaint must be served upon a person who is a trustee of a dissolved corporation and its stockholders. Although California Corporations Code § 2011 allows officers, directors and shareholders to be served, California courts have concluded that the Corporations Code "does not apply to foreign corporations which have dissolved." *North American Asbestos Corp. v. Superior Court*, 128 Cal.App.3d 138, 144, 179 Cal.Rptr. 889 (1982). Nonetheless, under Section 27 of the Act, if the district court finds that Mobile's acts were sufficient to confer personal jurisdiction, appellents should be allowed to perfect service of process.

from the record that they transact, or have ever transacted, business within the Central District, we need to determine whether venue is proper based upon whether any act or transaction constituting a violation occurred in the Central District.

[13] It does not appear from the briefs filed in this case, or from the record below, that Appellees Ferri or Mobile had any actual contacts with the forum (the Central District of California) or that they performed any acts within the forum in violation of the Act. However, "[t]he 'act' contemplated by the statute need not be crucial, nor must 'the fraudulent scheme be hatched in the forum district.'" *Hilgeman v. National Insurance Co. of America*, 547 F.2d at 301 (quoting *Hooper v. Mountain State Securities Corp.*, 282 F.2d 195, 204 (5th Cir.1960)). "Without question, the intent of the venue and jurisdiction provisions of the securities laws is to grant potential plaintiffs liberal choice in their selection of a forum." *Ritter v. Zuspan*, 451 F.Supp. 926, 928 (E.D.Mich.1978), and unless the balance of factors is strongly in favor of the defendants, the plaintiff's choice of forum should rarely be disturbed. *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508, 67 S.Ct. 839, 843, 91 L.Ed. 1055 (1947).

[14, 15] Appellants argue that a co-conspirator venue theory should be applied to determine venue in an action brought for violations under the Act in which there are numerous defendants, and where there is more than one appropriate forum in which to bring the action. We agree, and note that the Supreme Court has stated in dictum, "that in the unusual case in which it is not clear that the claim arose in only one specific district, a plaintiff may choose between those two (or conceivably even more) districts that with approximately equal plausibility ... may be assigned as the locus of the claim." *Leroy v. Great Western United Corp.*, 443 U.S. at 185, 99 S.Ct. at 2717. (citation omitted). In this case, since the defendants are generally located in either California or Florida, and the securities broker-dealer corporations engaged by the defendants in furtherance of their scheme, Sebag and FSSC, had their principal places of business in California and Florida, respectively, this action could have been maintained with "approximately equal plausibility" in either state. There is an important interest to be served by joining all defendants in one action, thereby avoiding duplicitous litigation and inconsistent results. *Wyndham Associates v. Bintliff*, 398 F.2d 614, 619 (2d Cir.), *cert. denied*, 393 U.S. 977, 89 S.Ct. 444, 21 L.Ed.2d 438 (1968).

[16] Under the co-conspirator venue theory, where an action is brought against multiple defendants alleging a common scheme of acts or transactions in violation of securities statutes, so long as venue is established for any of the defendants in the forum district, venue is proper as to all defendants. This is true even in the absence of any contact by some of the defendants in the forum district. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction § 3824 (1986).

[17] The co-conspirator venue theory has been adopted by the Second and Fifth Circuits as applied to multi-defendant litigation alleging violations of the federal securities statutes.[4] In addition, this venue theory has been widely adopted by the federal district courts in securities litigation.[5] We agree with these courts. The

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[4] *Wyndham Associates v. Bintliff*, 398 F.2d 614 (2d Cir.), *cert. denied*, 393 U.S. 977, 89 S.Ct. 444, 21 L.Ed.2d 438 (1968); *Hilgeman v. National Insurance Co. of America*, 547 F.2d 298 (5th Cir.1977).

[5] *See e.g., Stewart v. Fry*, 575 F.Supp. 753 (E.D. Mo.1983); *DeMoss v. First Artists Production Co., Ltd.*, 571 F.Supp. 409 (N.D.Ohio

strong policy favoring the litigation of related claims in the same forum supports the application of a co-conspirator venue theory in actions based upon violations of federal securities statutes.

[18] We recognize that in adopting the co-conspirator venue theory in this Circuit, "it is inevitable that some party will be inconvenienced no matter where the suit is tried." *Wyndham Associates v. Bintliff,* 398 F.2d at 620-621. However, the invonvenience of requiring one defendant in a multi-defendant action to litigate in a distant forum is greatly outweighed by the interest of judicial economy and bringing together in one lawsuit, all related claims and alternative theories.

Ferri and Mobile claim that even assuming a co-conspirator venue theory apples to a securities action, appellants have not alleged sufficient facts to connect them to the alleged conspiracy, and therefore venue is not proper. We agree that a plaintiff's complaint must set out more than mere bald allegations of a claim. However, "a complaint need only set out a generalized statement of facts from which [a] defendant will be able to frame a responsive pleading." Wright & Miller, Federal Practice and Procedure: Civil § 1357 (1969); *See also, Kadar Corp. v. Milbury,* 549 F.2d 230, 233 (1st Cir.1977).

1983); *Hill v. Turner,* 492 F.Supp. 61 (M.D.Pa.1980); *Securities and Exchange Commission v. Diversified Industries, Inc.,* 465 F.Supp. 104 (D.D.C.1979); *Warren v. Bokum Resources Corp.,* 433 F.Supp. 1360 (D.N.M.1977); *Berlozzi v. King Louie International, Inc.,* 420 F.Supp. 1166 (D.R.I.1976); *Arpel v. Homas,* 390 F.Supp. 908 (W.D.Pa.1975); *Securities and Exchange Commission v. National Student Marketing Corp.,* 360 F.Supp. 284 (D.D.C.1973); *Levin v. Great Western Sugar Co.,* 274 F.Supp. 974 (D.N.J.1967); *Zorn v. Anderson,* 263 F.Supp. 745 (S.D.N.Y.1966).

The appellants have alleged that Ferri maintained securities accounts at FSSC and that Mobile maintained a securities accout at A.G. Becker, incorporated through FSSC. Although we question whether these facts are sufficient to connect Appellees Ferri and Mobile with the alleged scheme engaged in by the other defendants, and which appellants allege to be in violation of federal securities law, we are mindful of the liberal pleading amendment provisions of the Federal Rules of Civil Procedure. *See* Fed.R.Civ.P. 15(a) (leave to amend shall be freely given when justice so requires). Thus, upon remand, the district court should allow appellants to amend their pleadings to show the nexus between these two defendants and the scheme in which the other defendants are involved.

E. Pendent State Claims

In addition to violations of the Act, appellants asserted a claim for common law fraud against Appellees Ferri and Mobile. This pendent state claim was dismissed when the district court dismissed the entire complaint without leave to amend as to Appellees Ferri and Mobile.

[19] The determination of whether to exercise jurisdiction over pendent state claims is within the discretion of the disctrict court, and the district court is not required to exercise such jurisdiction. *United Mine Workers v. Gibbs,* 383 U.S. 715, 726, 86 S.Ct. 1130, 1139, 16 L.Ed.2d 218 (1966); *Kehr v. Smith Barney Harris Upham & Co.,* 736 F.2d 1283, 1287 (9th Cir.1984). Thus, on remand, we leave to the discretion of the district court whether the claim for common law fraud against Ferri and Mobile should be reinstated.

III. CONCLUSION

The appropriate standard to be applied in determining whether the district court has personal jurisdiction over defendants in an action brought under the Securities and Exchange Act of 1934, is whether that defendant had sufficient contacts with the United States and not whether the defendant had sufficient contacts with the forum district. The district court clearly had personal jurisdiction over Appellee Ferri, a United States resident. If the district court, on remand, finds that Appellee Mobile had sufficient contacts with the United States, and that its acts caused foreseeable consequences, then it would have personal jurisdiction over Mobile as well.

The district court erred in failing to adopt a co-conspirator venue theory in this action. Since we hold that such a theory applies to actions brought under the federal securities laws, the district court, on remand, should allow the appellants to amend their pleadings to demonstrate the relationship between these two defendants and the predatory manipulative scheme engaged in by the other defendants.

CHAPTER 96 — RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT, 18 U.S.C.A. §§ 1961-68 (WEST. 1984)

§ 1961. Definitions

As used in this chapter —

(1) "racketeering activity" means (A) any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under

any of the following provisions of title 18, United States Code: Section 201 (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1951 (relating to interference with commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), sections 2314 and 2315 (relating to interstate transportation of stolen property), sections 2341-2346 (relating to trafficking in contraband cigarettes), sections 2421-24 (relating to white slave traffic), (C) any act which is indictable under title 29, United States Code, section 186 (dealing with restrictions on payments and loans to labor organizations) or section 501(c) (relating to embezzlement from union funds), or (D) any offense involving fraud connected with a case under title 11, fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous

drugs, punishable under any law of the United States;

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a State or political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States, a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter;

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether any person has been involved in any violation of this chapter or of any final order, judgment, or decree of any court of the United States, duly entered in any case or proceeding arising under this chapter;

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter. Any department or agency so designated may use in investigations authorized by this chapter either the investigative provisions of this chapter or the investigative power of such department or agency otherwise conferred by law.

(Added Pub.L. 91–452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 941, and amended Pub.L. 95–575, § 3(c), Nov. 2, 1978, 92 Stat. 2465; Pub.L. 95–598, Title III, § 314(g), Nov. 6, 1978, 92 Stat. 2677.)

§ 1962. Prohibited activities

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprises's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections[1] (a), (b), or (c) of this section.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 942.)

§ 1963. Criminal penalties

(a) Whoever violates any provision of section 1962 of this chapter shall be fined not more than $25,000 or imprisoned not more than twenty years, or both, and shall forfeit to the United States (1) any interest he has acquiried or maintained in violation of section 1962, and (2) any interest in, security of, claim agasinst, or property or contractual right of any kind affording a source of influence over, any enterprise which he has established, operated, controlled, conducted, or participated in the conduct of, in violation of section 1962.

(b) In any action brought by the United States under this section, the district courts of the United States shall have jurisdiction to enter such restraining orders or prohibitions, or to take such other actions, including, but not limited to, the acceptance of satisfactory performance bonds, in connection with any property or other interest subject to forfeiture under this section, as it shall deem proper.

(c) Upon conviction of a person under this section, the court shall authorize the Attorney General to seize all property or other interest declared forfeited under this section upon such terms and conditions as the court shall deem proper. If a property right or other interest is not exercisable or transferable for value by the United States,

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[1]So in original. Probably should be "subsection".

it shall expire, and shall not revert to the convicted person. All provisions of law relating to the disposition of property, or the proceeds from the sale thereof, or the remission or mitigation of forfeitures for violation of the customs laws, and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to forfeitures incurred, or alleged to have been incurred, under the provisions of this section, insofar as applicable and not inconsistent with the provisions hereof. Such duties as are imposed upon the collector of customs or any other person with respect to the disposition of property under the customs laws shall be performed under this chapter by the Attorney General. The United States shall dispose of all such property as soon as commercially feasible, making due provision for the rights of innocent persons.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 943.)

§ 1964. Civil remedies

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. In any action brought by the United States under this section, the court shall proceed as soon as practicable to the hearing and determination thereof. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter shall estop the defendant from denying the essential allegations of the criminal offense in any subsequent civil proceeding brought by the United States.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 943.

§ 1965. Venue and process

(a) Any civil action or proceeding under this chapter against any person may be instituted in the district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

(b) In any action under section 1964 of this chapter in any district court of the United States in which it is shown that the ends of justice require that other parties residing in any other district be brought before the court, the court may cause such parties to be summoned, and

process for that purpose may be served in any judicial district of the United States by the marshal thereof.

(c) In any civil or criminal action or proceeding instituted by the United States under this chapter in the district court of the United States for any judicial district, subpenas issued by such court to compel the attendance of witnesses may be served in any other judicial district, except that in any civil action or proceeding no such subpena shall be issued for service upon any individual who resides in another district at a place more than one hundred miles from the place at which such court is held without approval given by a judge of such court upon a showing of good cause.

(d) All other process in any action or proceeding under this chapter may by be served on any person in any judicial district in which such person resides, is found, has an agent, or transacts his affairs.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 944.)

§ 1966. Expedition of actions

In any civil action instituted under this chapter by the United States in any district court of the United States, the Attorney General may file with the clerk of such court a certificate stating that in his opinion the case is of general public importance. A copy of that certificate shall be furnished immediately by such clerk to the chief judge or in his absence to the presiding district judge of the district in which such action is pending. Upon receipt of such copy, such judge shall designate immediately a judge of that district to hear and determine action. The judge so designated shall assign such action for hearing as soon as practicable, participate in the hearings and

determination thereof, and cause such action to be expedited in every way.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 944.)

§ 1967. Evidence

In any proceeding ancillary to or in any civil action instituted by the United States under this chapter the proceedings may be open or closed to the public at the discretion of the court after consideration of the rights of affected persons.

(Added Pub.L. 91-452, Title IX, § 901(a), Oct. 15, 1970, 84 Stat. 944.)

§ 1968. Civil investigative demand

(a) Whenever the Attorney General has reason to believe that any person or enterprise may be in possession, custody, or control of any documentary materials relevant to a racketeering investigation, he may, prior to the institution of a civil or criminal proceeding thereon, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to produce such material for examination.

(b) Each such demand shall —

(1) state the nature of the conduct constituting the alleged racketeering violation which is under investigation and the provision of law applicable thereto;

(2) describe the class or classes of documentary material produced thereunder with such definiteness and certainty as to permit such material to be fairly identified;

(3) state that the demand is returnable forthwith or prescribe a return date which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying or reproduction; and

(4) identify the custodian to whom such material shall be made available.

(c) No such demand shall —

(1) contain any requirement which would be held to be unreasonable if contained in a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation; or

(2) require the production of any documentary evidence which would be privileged from disclosure if demanded by a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation.

(d) Service of any such demand or any petition filed under this section may be made upon a person by —

(1) delivering a duly executed copy thereof to any partner, executive officer, managing agent, or general agent thereof, or to any agent thereof authorized by appointment or by law to receive service of process on behalf of such person, or upon any individual person;

(2) delivering a duly executed copy thereof to the principal office or place of business of the person to be served; or

(3) depositing such copy in the United States mail, by registered or certified mail duly addressed

to such person at its principal office or place of business.

SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C.S. 78j (LAW CO-OP. 1983)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, or any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(June 6, 1934, ch 404, Title I, § 10, 48 Stat. 891.)

SECURITIES AND EXCHANGE COMMISSION
RULE 10b-5, 17 CFR § 240.10b-5 (1989)

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud,

(b) To employ any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

(Sec. 10; 48 Stat. 891; 15 U.S.C. 78j)

[13 FR 8183, Dec. 22, 1948, as amended at 16 FR 7928, Aug. 11, 1951]

SECURITIES INVESTOR PROTECTION ACT OF 1970, 15 U.S.C.S. §§ 78aaa-78*lll* (LAW Co-op. 1983)

§ 78aaa. Short title

This Act, with the following table of contents, may be cited as the "Securities Investor Protection Act of 1970".

(Dec. 30, 1970, P. L. 91-598, § 1(a), 84 Stat. 1636.)

§ 78bbb. Application of Securities Exchange Act of 1934

Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 (15 U.S.C. sec. 78a and fol.; hereinafter referred to as the "1934 Act") apply as if this Act constituted an amendment to, and was included as a section of, such Act.

(Dec. 30, 1970, P. L. 91-598, § 2, 84 Stat. 1637.)

§ 78ccc. Securities Investor Protection Corporation

(a) Creation and membership. (1) *Creation.* There is hereby established a body corporate to be known as the "Securities Investor Protection Corporation" (hereafter in this Act referred to as "SIPC"). SIPC shall be a nonprofit corporation and shall have succession until dissolved by Act of the Congress. SIPC shall—

(A) not be an agency or establishment of the United States Government; and

(B) except as otherwise provided in this Act, be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act (D.C. Code, section 29-1001 and fol.).

(2) Membership. (A) Members of SIPC. SIPC shall be a membership corporation the members of which shall be all persons registered as brokers or dealers under section 15(b) of the 1934 Act [15 USCS § 78*o*(b)], other than—

(i) persons whose principal business, in the determination of SIPC, taking into account business of affiliated entities, is conducted outside the United States and its territories and possessions; and

(ii) persons whose business as a broker or dealer consists exclusively of (I) the distribution of shares of registered open end investment companies or unit investment trusts, (II) the sale of variable annuities, (III) the business of insurance, or (IV) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

(B) Commission review. SIPC shall file with the Commission a copy of any determination made pursuant to subparagraph (A)(i). Within thirty days after the date of such filing, or within such longer period as the Commission may designate of not more than ninety days after such date if it finds such longer period to be appropriate and publishes its reasons for so finding, the Commission shall, consistent with the public interest and the purposes of this Act, affirm, reverse, or amend any such determination of SIPC.

(C) Additional members. SIPC shall provide by rule that persons excluded from membership in SIPC under subparagraph (A)(i) may become members of SIPC under such conditions and upon such terms as SIPC shall require by rule, taking into account such matters as the availability of assets and the ability to conduct a liquidation if necessary.

(D) Disclosure. Any broker or dealer excluded from membership in SIPC under subparagraph (A)(i) shall, as required by the Commission by rule, make disclosures of its exclusion and other relevant information to the customers of such broker or dealer who are living in the United States or its territories and possessions.

(b) Powers. In addition to the powers granted to SIPC elsewhere in this Act, SIPC shall have the power —

(1) to sue and be sued, complain and defend, in its corporate name and through its counsel, in any State, Federal, or other court;

(2) to adopt, alter, and use a corporate seal, which shall be judicially noticed;

(3) to adopt, amend, and repeal, by its Board of Directors, such bylaws as may be necessary or appropriate to carry out the purposes of this Act, including bylaws relating to —

(A) the conduct of its business; and

(B) the indemnity of its directors, officers, and employees (including any such person acting as trustee or otherwise in connection with a liquidation proceeding) for liabilities and expenses actually and reasonably incurred by any such person in connection with the defense or settlement of an action or suit if such person acted in good faith and in a manner reasonably believed to be consistent with the purposes of this Act.[;]

(4) to adopt, amend, and repeal, by its Board of Directors, such rules as may be necessary or appropriate to carry out the purposes of this Act, including rules relating to —

(A) the definition of terms used in this Act, other than those terms for which a definition is provided in section 16 [15 USCS § 78*111*];

(B) the procedures for the liquidation of members and direct payment procedures, including the transfer of customer accounts, the distribution of

customer property, and the advance and payment of SIPC funds; and

(C) the exercise of all other rights and powers granted to it by this Act;

(5) to conduct its business (including the carrying on of operations and the maintenance of offices) and to exercise all other rights and powers granted to it by this Act in any State or other jurisdiction without regard to any qualification, licensing, or other statute in such State or other jurisdiction;

(6) to lease, purchase, accept gifts or donations of or otherwise acquire, to own, hold, improve, use, or otherwise deal in or with, and to sell, convey, mortgage, pledge, lease, exchange or otherwise dispose of, any property, real, personal or mixed, or any interest therein, wherever situated;

(7) Subject to the provisions of subsection (c), to elect or appoint such officers, attorneys, employees, and agents as may be required, to determine their qualifications, to define their duties, to fix their salaries, require bonds for them and fix the penalty thereof;

(8) to enter into contracts, to execute instruments, to incur liabilities, and to do any and all other acts and things as may be necessary or incidental to the conduct of its business and the exercise of all other rights and powers granted to SIPC by this Act; and

(9) by bylaw, to establish its fiscal year.

(c) Board of Directors. (1) *Functions.* SIPC shall have a Board of Directors, which, subject to the provisions of this Act, shall determine the policies which shall govern the operations of SIPC.

(2) *Number and appointment.* The Board of Directors shall consist of seven persons as follows:

(A) One director shall be appointed by the Secretary of the Treasury from among the officers and employees of the Department of the Treasury.

(B) One director shall be appointed by the Federal Reserve Board from among the officers and employees of the Federal Reserve Board.

(C) Five directors shall be appointed by the President, by and with the advice and consent of the Senate, as follows—

(i) three such directors shall be selected from among persons who are associated with, and representative of different aspects of, the securities industry, not all of whom shall be from the same geographical area of the United States, and

(ii) two such directors shall be selected from the general public from among persons who are not associated with a broker or dealer or associated with a member of a national securities exchange, within the meaning of section 3(a)(18) or section 3(a)(21), respectively, of the 1934 Act [15 USCS § 78c(a)(18), (21)], or similarly associated with any sef-regulatory organization or other securities industry group, and who have not had any such association during the two years preceding appointment.

(3) *Chairman and vice chairman.* The President shall designate a Chairman and Vice Chairman from among those directors appointed under paragraph (2)(C)(ii) of this subsection.

(4) *Terms.* (A) Except as provided in subparagraphs (B) and (C), each director shall be appointed for a term of three years.

(B) Of the directors first appointed under paragraph (2) —

(i) two shall hold office for a term expiring on December 31, 1971,

(ii) two shall hold office for a term expiring on December 31, 1972, and

(iii) three shall hold office for a term expiring on December 31, 1973,

as designated by the President at the time they take office. Such designation shall be made in a manner which will assure that no two persons appointed under the authority of the same clause of para graph (2)(C) shall have terms which expire simultaneously.

(C) A vacancy in the Board shall be filled in the same manner as the original appointment was made. Any director appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the remainder of such term. A director may serve after the expiration of his term until his successor has taken office.

(5) *Compensation.* All matters relating to compensation of directors shall be as provided in the bylaws of SIPC.

(d) Meetings of Board. The Board of Directors shall meet at the call of its Chairman, or as otherwise provided by the bylaws of SIPC.

(e) Bylaws and rules. (1) *Proposed bylaw changes.* The Board of Directors of SIPC shall file with the Commission a copy of any proposed bylaw or any proposed amendment to or repeal of any bylaw of SIPC (hereinafter in this paragraph collectively referred to as a "proposed bylaw change"), accompanied by a concise general statement of the basis and purpose of such proposed bylaw change. Each such proposed bylaw change shall take effect thirty days after the date of the filing of a copy thereof with the Commission, or upon such later date as SIPC may designate or such earlier date as the Commission may determine, unless —

(A) the Commission, by notice to SIPC setting forth the reasons therefor, disapproves such proposed bylaw change as being contrary to the public interest or contrary to the purposes of this Act; or

(B) the Commission finds that such proposed bylaw change involves a matter of such significant public interest that public comment should be obtained, in which case it may, after notifying SIPC in writing of such finding, require that the procedures set forth in paragraph (2) be followed with respect to such proposed bylaw change, in the same manner as if such proposed bylaw change were a proposed rule change within the meaning of such paragraph.

(2) *Proposed rule changes.* (A) Filing of proposed rule changes. The Board of Directors of SIPC shall file with the Commission, in accordance with such rules as the Commission may prescribe, a copy of any proposed rule or any proposed amendment to or repeal of any rule of SIPC (hereinafter in this subsection collectively referred to as a "proposed rule change"), accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing

of any proposed rule change, publish notice thereof, together with the terms of substance of such proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments with respect to such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this paragraph.

(B) Action by the commission. Within thirty-five days after the date of publication of notice of the filing of a proposed rule change, or within such longer period as the Commission may designate of not more than ninety days after such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or as to which SIPC consents, the Commission shall —

(i) by order approve such proposed rule change; or

(ii) institute proceedings to determine whether such proposed rule change should be disapproved.

(C) Proceedings. Proceedings instituted with respect to a proposed rule change pursuant to subparagraph (B)(ii) shall include notice of the grounds for disapproval under consideration and opportunity for hearing, and shall be concluded within one hundred eighty days after the date of publication of notice of the filing of such proposed rule change. At the conclusion of such proceedings, the Commission shall, by order, approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for not more than sixty days if it finds good cause for such extension and publishes its reasons for so finding, or for such longer period as to which SIPC consents.

(D) Grounds for approval or dissapproval. The Commission shall approve a proposed rule change if its finds that such proposed rule change is in the public interest and is consistent with the purposes of this Act, and any proposed rule change so approved shall be given force and effect as if promulgated by the Commission. The Commission shall disapprove a proposed rule change if it does not make the finding referred to in the preceding sentence. The Commission shall not approve any proposed rule change prior to thirty days after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(E) Exception. Notwithstanding any other provision of this paragraph, a proposed rule change may take effect —

(i) upon the date of filing with the Commission, if such proposed rule change is designated by SIPC as relating solely to matters which the Commission, consistent with the public interest and the purposes of this subsection, determines by rule do not require the procedures set forth in this paragraph; or

(ii) upon such date as the Commission shall for good cause determine. Any proposed rule change which takes effect under this clause shall be filed promptly thereafter and reviewed in accordance with the provisions of subparagraph (A).

At any time within sixty days after the date of filing of any rule change which has taken effect pursuant to this subparagraph, the Commission may summarily abrogate such rule change and require that it be refiled and reviewed in accordance with the provisions of this paragraph, if the Commission finds that such action is neces-

sary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act. Any action of the Commission pursuant to the preceding sentence shall not affect the validity or force of a rule change during the period it was in effect and shall not be reviewable under section 25 of the 1934 Act [15 USCS § 78y] or deemed to be final agency action for purposes of section 704 of title 5, United States Code [5 USCS § 704].

(3) *Action required by Commission.* The Commission may, by such rules as it determines to be necessary or appropriate in the public interest or to carry out the purposes of this Act, require SIPC to adopt, amend, or repeal any SIPC bylaw or rule, whenever adopted.

(Dec. 30, 1970, P. L. 91-598, § 3, 84 Stat. 1637; May 21, 1978, P. L. 95-283, §§ 2-5, 92 Stat. 249-251.)

§ 78ddd. SIPC Fund

(a) In general. (1) *Establishment of fund.* SIPC shall establish a "SIPC Fund" (hereinafter in this Act referred to as the "fund"). All amounts received by SIPC (other than amounts paid directly to any lender pursuant to any pledge securing a borrowing by SIPC) shall be deposited in the fund, and all expenditures made by SIPC shall be made out of the fund.

(2) *Balance of the fund.* Except as otherwise provided in this section, the balance of the fund at any time shall consist of the aggregate at such time of the following items:

(A) Cash on hand or on deposit.

(B) Amounts invested in United States Government or agency securities.

(C) Such confirmed lines of credit as SIPC may from time to time maintain, other than those maintained pursuant to paragraph (4).

(3) *Confirmed lines of credit.* For purposes of this section, the amount of confirmed lines of credit as of any time is the aggregate amount which SIPC at such time has the right to borrow from banks and other financial institutions under confirmed lines of credit or other written agreements which provide that moneys so borrowed are to be repayable by SIPC not less than one year from the time of such borrowings (including, for purposes of determining when such moneys are repayable, all rights of extension, refunding, or renewal at the election of SIPC).

(4) *Other lines.* SIPC may maintain such other confirmed lines of credit as it considers necessary or appropriate, and such other confirmed lines of credit shall not be included in the balance of the fund, but amounts received from such lines of credit may be disbursed by SIPC under this Act as though such amounts were part of the fund.

(b) Initial required balance for fund. Within one hundred and twenty days from the date of enactment of this Act [enacted Dec. 30, 1970], the balance of the fund shall aggregate not less than $75,000,000, less any amounts expended from the fund within that period.

(c) Assessments. (1) *Initial assessments.* Each member of SIPC shall pay to SIPC, or the collection agent for SIPC specified in section 9(a) [15 USCS § 78iii(a)], on or before the one hundred and twentieth day following the date of enactment of this Act [enacted Dec. 30, 1970], an assessment equal to one-eighth of 1 per centum of the gross revenues from the securities business of such mem-

ber during the calendar year 1969, or if the Commission shall determine that, for purposes of assessment pursuant to this paragraph, a lesser percentage of gross revenues from the securities business is appropriate for any class or classes of members (taking into account relevant factors, including but not limited to types of business done and nature of securities sold), such lesser percentages as the Commission, by rule or regulation, shall establish for such class or classes, but in no event less than one-sixteenth of 1 per centum for any such class. In no event shall any assessment upon a member pursuant to this paragraph be less than $150.

(2) *General assessment authority.* SIPC shall, by bylaw, impose upon its members such assessments as, after consultation with self-regulatory organizations, SIPC may deem necessary and appropriate to establish and maintain the fund and to repay any borrowings by SIPC. Any assessments so made shall be in conformity with contractual obligations made by SIPC in connection with any borrowing incurred by SIPC. Subject to paragraph (3) and subsection (d)(1)(A), any such assessment upon the members, or any one or more classes thereof, may, in whole or in part, be based upon or measured by (A) the amount of their gross revenues from the securities business, or (B) all or any of the following factors: the amount or composition of their gross revenues from the securities business, the number or dollar volume of transactions effected by them, the number of customer accounts maintained by them or the amounts of cash and securities in such accounts, their net capital, the nature of their activities (whether in the securities business or otherwise) and the consequent risks, or other relevant factors.

(3) *Limitations.* Notwithstanding any other provision of this Act —

(A) no assessment shall be made upon a member otherwise than pursuant to paragraph (1) or (2) of this subsection,

(B) an assessment may be made under paragraph (2) of this subsection at a rate in excess of one-half of one per centum during any twelve-month period if SIPC determines, in accordance with a bylaw, that such rate of assessment during such period will not have a material adverse effect on the financial condition of its members or their customers, except that no assessments shall be made pursuant to such paragraph upon a member which require payments during any such period which exceed in the aggregate one per centum of such member's gross revenues from the securities business for such period, and

(C) no assessment shall include any charge based upon the member's activities (i) in the distribution of shares of registered open end investment companies or unit investment trusts, (ii) in the sale of variable annuities, (iii) in the business of insurance, or (iv) in the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

(d) Requirements respecting assessments and lines of credit. (1) *Assessments.* (A) ½ of 1 percent assessment. Subject to subsection (c)(3), SIPC shall impose upon each of its members an assessment at a rate of not less

than one-half of 1 per centum per annum of the gross revenues from the securities business of such member —

(i) until the balance of the fund aggregates not less than $150,000,000 (or such other amount as the Commission may determine in the public interest),

(ii) during any period when there is outstanding borrowing by SIPC pursuant to subsection (f) or subsection (g) of this section, and

(iii) whenever the balance of the fund (exclusive of confirmed lines of credit) is below $100,000,000 (or such other amount as the Commission may determine in the public interest).

(B) ¼ of 1 percent assessment. During any period during which —

(i) the balance of the fund (exclusive of confirmed lines of credit) aggregates less than $150,000,000 (or such other amount as the Commission has determined under paragraph (2)(B)), or

(ii) SIPC is required under paragraph (2)(B) to phase out of the fund all confirmed lines of credit,

SIPC shall endeavor to make assessments in such a manner that the aggregate assessments payable by its members during such period shall not be less than one-fourth of 1 per centum per annum of the aggregate gross revenues from the securities business for such members during such period.

(C) Minimum assessment. The minimum assessment imposed upon each member of SIPC shall be $25 per annum through the year ending December 31, 1979, and thereafter shall be the amount from time to time set by

SIPC bylaw, but in no event shall the minimum assessment be greater than $150 per annum.

(2) *Lines of credit.* (A) $50,000,000 limit after 1973. After December 31, 1973, confirmed lines of credit shall not constitute more than $50,000,000 of the balance of the fund.

(B) Phaseout requirement. When the balance of the fund aggregates $150,000,000 (or such other amount as the Commission may determine in the public interest) SIPC shall phase out of the fund all confirmed lines of credit.

(e) Prior trusts; overpayments and underpayments. (1) *Prior trusts.* There may be contributed and transferred at any time to SIPC any funds held by any trust established by a self-regulatory organization prior to January 1, 1970, and the amounts so contributed and transferred shall be applied, as may be determined by SIPC with approval of the Commission, as a reduction in the amounts payable pursuant to assessments made or to be made by SIPC upon members of such self-regulatory organization pursuant to subsection (c)(2). No such reduction shall be made at any time when there is outstanding any borrowing by SIPC pursuant to subsection (g) of this section or any borrowings under confirmed lines of credit.

(2) *Overpayments.* To the extent that any payment by a member exceeds the maximum rate permitted by subsection (c) of this section, the excess shall be recoverable only against future payments by such member, except as otherwise provided by SIPC bylaw.

(3) *Underpayments.* If a member fails to pay when due all or any part of an assessment made upon such member, the unpaid portion thereof shall bear interest at

such rate as may be determined by SIPC bylaw and, in addition to such interest, SIPC may impose such penalty charge as may be determined by SIPC bylaw. Any such penalty charge imposed upon a SIPC member shall not exceed 25 per centum of any unpaid portion of the assessment. SIPC may waive such penalty charge in whole or in part in circumstances where it considers such waiver appropriate.

(f) Borrowing authority. SIPC shall have the power to borrow moneys and to evidence such borrowed moneys by the issuance of bonds, notes, or other evidences of indebtedness, all upon such terms and conditions as the Board of Directors may determine in the case of a borrowing other than pursuant to subsection (g) of this section, or as may be prescribed (g). The interest payable on a borrowing pursuant to subsection (g) shall be equal to the interest payable on the related notes or other obligations issued by the Commission to the Secretary of the Treasury. To secure the payment of the principal of, and interest and premium, if any, on, all bonds, notes, or other evidences of indebtedness so issued, SIPC may make agreements with respect to the amount of future assessments to be made upon members and may pledge all or any part of the assets of SIPC and of the assessments made or to be made upon members. Any such pledge of future assessments shall (subject to any prior pledge) be valid and binding from the time that it is made, and the assessments so pledged and thereafter received by SIPC, or any collection agent for SIPC, shall immediately be subject to the lien of such pledge without any physical delivery thereof or further act, and the lien of such pledge shall be valid and binding against all parties having claims of any kind against SIPC or such collection agent whether pursuant to this Act, in tort, contract or otherwise, irrespective of whether such parties

have notice thereof. During any period when a borrowing by SIPC pursuant to subsection (g) of this section is outstanding, no pledge of any assessment upon a member to secure any bonds, notes, or other evidences of indebtedness issued other than pursuant to subsection (g) of this section shall be effective as to the excess of the payments under the assessment on such member during any twelve-month period over one-fourth of 1 per centum of such member's gross revenues from the securities business for such period. Neither the instrument by which a pledge is authorized or created, nor any statement or other document relative thereto, need be filed or recorded in any State or other jurisdiction. The Commission may by rule or regulation provide for the filing of any instrument by which a pledge or borrowing is authorized or created, but the failure to make or any defect in any such filing shall not affect the validity of such pledge or borrowing.

(g) SEC Loans to SIPC. In the event that the fund is or may reasonably appear to be insufficient for the purposes of this Act, the Commission is authorized to make loans to SIPC. At the time of application for, and as a condition to, any such loan, SIPC shall file with the Commission a statement with respect to the anticipated use of the proceeds of the loan. If the Commission determines that such loan is necessary for the protection of customers of brokers or dealers and the maintenance of confidence in the United States securities markets and that SIPC has submitted a plan which provides as reasonable an assurance of prompt repayment as may be feasible under the circumstances, then the Commission shall so certify to the Secretary of the Treasury, and issue notes or other obligations to the Secretary of the Treasury pursuant to subsection (h). If the Commission determines that the amount or time for payment of the assess-

ments pursuant to such plan would not satisfactorily provide for the repayment of such loan, it may, by rules and regulations, impose upon the purchasers of equity securities in transactions on national securities exchanges and in the over-the-counter markets a transaction fee in such amount as at any time or from time to time it may determine to be appropriate, but not exceeding one-fiftieth of 1 per centum of the purchase price of the securities. No such fee shall be imposed on a transaction (as defined by rules or regulations of the commission) of less than $5,000. For the purposes of the next preceding sentence, (1) the fee shall be based upon the total dollar amount of each purchase; (2) the fee shall not apply to any purchase on a national securities exchange or in an over-the-counter market by or for the account of a broker or dealer registered under section 15(b) of the 1934 Act [15 USCS § 78*o*(b)] unless such purchase is for an investment account of such broker or dealer (and for this purpose any transfer from a trading account to an investment account shall be deemed a purchase at fair market value); and (3) the Commission may, by rule, exempt any transaction in the the over-the-counter markets or on any national securities exchange where necessary to provide for the assessment of fees on purchasers in transactions in such markets and exchanges on a comparable basis. Such fee shall be collected by the broker or dealer effecting the transaction for or with the purchaser, or by such other person as provided by the commission by rule, and shall be paid to SIPC in the same manner as assessments imposed pursuant to subsection (c) but without regard to the limits on such assessments, or in such other manner as the Commission may by rule provide.

(h) SEC notes issed to Treasury. To enable the Commission to make loans under subsection (g), the Commission is authorized to issue to the Secretary of the

Treasury notes or other obligations in an aggregate amount of not to exceed $1,000,000,000, in such forms and denominations, bearing such maturities, and subject to such terms and conditions, as may be prescribed by the Secretary of the Treasury. Such notes or other obligations shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities during the month preceding the issuance of the notes or other obligations. The Secretary of the Treasury may reduce the interest rate if he determines such reduction to be in the national interest. The Secretary of the Treasury is authorized and directed to purchase any notes and other obligations issued hereunder and for that purpose he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act, as amended, are extended to include any purchase of such notes and obligations. The Secretary of the Treasury may at any time sell any of the notes or other obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such notes or other obligations shall be treated as public debt transactions of the United States.

(i) Consolidated group. Except as otherwise provided by SIPC bylaws, gross revenues from the securities business of a member of SIPC shall be computed on a consolidated basis for such member and all its subsidiaries (other than the foreign subsidiaries of such member), and the operations of a member of SIPC shall include those of any business to which such member has succeeded.

(Dec. 30, 1970, P. L. 91-598, § 4, 84 Stat. 1639; May 21, 1978, P. L. 95-283, § 6, 92 Stat. 253.)

§ 78eee. Protection of customers

(a) Determination of need of protection. (1) *Notice to SIPC.* If the Commission or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, it shall immediately notify SIPC, and, if such notification is by a self-regulatory organization, the Commission.

(2) *Action by self-regulatory organization.* If a self-regulatory organization has given notice to SIPC pursuant to subsection (a)(1) with respect to a broker or dealer, and such broker or dealer undertakes to liquidate or reduce its business either pursuant to the direction of a self-regulatory organization or voluntarily, such self-regulatory organization may render such assistance or oversight to such broker or dealer as it considers appropriate to protect the interests of customers of such broker or dealer. The assistance or oversight by a self-regulatory organization shall not be deemed the assumption or adoption by such self-regulatory organization of any obligation or liability to customers, other creditors, shareholders, or partners of the broker or dealer, and shall not prevent or act as a bar to any action by SIPC.

(3) *Action by SIPC.* If SIPC determines that —

(A) any member of SIPC (including any person who was a member within one hundred eighty days prior to such determination) has failed or is in danger of failing to meet its obligations to customers; and

(B) one or more of the conditions specified in subsection (b)(1) exist with respect to such member.

SIPC may, upon notice to such member, file an application for a protective decree with any court of competent jurisdiction specified in section 21(e) or 27 of the 1934 Act [15 USCS §§ 78u(e), 78aa], except that no such application shall be filed with respect to a member the only customers of which are persons whose claims could not be satisfied by SIPC advances pursuant to section 9 [15 USCS § 78fff-3].

(4) *Effect of other pending actions.* An application with respect to a member of SIPC filed with a court under paragraph (3) —

(A) may, with the consent of the Commission, be combined with any action brought by the Commission, including an action by the Commission for a temporary receiver pending an appointment of a trustee under subsection (b)(3); and

(B) may be filed notwithstanding the pendency in the same or any other court of any bankruptcy, mortgage foreclosure, or equity receivership proceeding or any proceeding to reorganize, conserve, or liquidate such member or its property, or any proceeding to enforce a lien against property of such member.

(b) Court action. (1) *Issuance of protective decree.* Upon receipt of an application by SIPC under subsection (a)(3), the court shall forthwith issue a protective decree if the debtor consents thereto, if the debtor fails to contest such application, or if the court finds that such debtor —

(A) is insolvent within the meaning of section 101 of title 11 of the United States Code [11 USCS

§ 101], or is unable to meet its obligations as they mature;

(B) is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed;

(C) is not in compliance with applicable requirements under the 1934 Act or rules of the Commission or any self-regulatory organization with respect to financial responsibility or hypothecation of customers' securities; or

(D) is unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules.

Unless the debtor consents to the issuance of a protective decree, the application shall be heard three business days after the date on which it is filed, or at such other time as the court shall determine, taking into consideration the urgency which the circumstances require.

(2) *Jurisdiction and powers of court.* (A) Exclusive jurisdiction. Upon the filing of an application with a court for a protective decree with respect to a debtor, such court —

(i) shall have exclusive jurisdiction of such debtor and its property wherever located (including property located outside the territorial limits of such court and property held by any other person as security for a debt or subject to a lien);

(ii) shall have exclusive jurisdiction of any suit against the trustee with respect to a liquidation proceeding; and

(iii) except as inconsistent with the provisions of this Act, shall have the jurisdiction, powers, and duties conferred upon a court of the United States having jurisdiction over cases under title 11 of the United States Code [11 USCS §§ 101 et seq.],

(B) Stay of pending actions. Pending the issuance of a protective decree under paragraph (1), the court with which an application has been filed —

(i) shall stay any pending bankruptcy, mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the debtor or its property and any other suit against any receiver, conservator, or trustee of the debtor or its property, and shall continue such stay upon appointment of a trustee pursuant to paragraph (3);

(ii) may stay any proceeding to enforce a lien against property of the debtor or any other suit against the debtor, including a suit by stockholders of the debtor which interferes with prosecution by the trustee of claims against former directors, officers, or employees of the debtor, and may continue such stay upon appointment of a trustee pursuant to paragraph (3);

(iii) may stay enforcement of, and upon appointment of a trustee pursuant to paragraph (3), may continue the stay for such period of time as may be appropriate, but shall not abrogate, any right of setoff, except to the extent such right may be affected under section 553 of title 11 of the United States Code [11 USCS § 553] and shall not abrogate the right to enforce a valid, nonpreferential lien or pledge against the property of the debtor; and

(iv) may appoint a temporary receiver.

(3) *Appointment of trustee and attorney.* If the court issues a protective decree under paragraph (1), such court shall forthwith appoint, as trustee for the liquidation of the business of the debtor and as attorney for the trustee, such persons as SIPC, in its sole discretion, specifies. The persons appointed as trustee and as attorney for the trustee may be associated with the same firm. SIPC may, in its sole discretion, specify itself or one of its employees as trustee in any case in which SIPC has determined that the liabilities of the debtor to unsecured general creditors and to subordinated lenders appear to aggregate less than $750,000 and that there appear to be fewer than five hundred customers of such debtor. No person may be appointed to serve as trustee or attorney for the trustee if such person is not disinterested within the meaning of paragraph (6), except that for any specified purpose other than to represent a trustee in conducting a liquidation proceeding, the trustee may, with the approval of SIPC and the court, employ an attorney who is not disinterested. A trustee appointed under this paragraph shall qualify by filing a bond in the manner prescribed by section 322 of title 11 of the United States Code [11 USCS § 322], except that neither SIPC nor any employee of SIPC shall be required to file a bond when appointed as trustee.

(4) *Removal to bankruptcy court.* Upon the issuance of a protective decree and appointement of a trustee, or a trustee and counsel, under this section, the court shall forthwith order the removal of the entire liquidation proceeding to the court of the United States in the same judicial district having jurisdiction over cases under title 11 [11 USCS §§ 101 et seq.]. The latter court shall thereupon have all of the jurisdiction, powers, and duties conferred by this Act upon the court to which application for the issuance of the protective decree was made.

(5) *Compensation for services and reimbursement of expenses.* (A) Allowances in general. The court shall grant reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred (hereinafter in this paragraph referred to as "allowances") by a trustee, and by the attorney for such a trustee, in connection with a liquidation proceeding. No allowances (other than reimbursement for proper costs and expenses incurred) shall be granted to SIPC or any employee or SIPC for serving as trustee. Allowances may be granted on an interim basis during the course of the liquidation proceeding at such times and in such amounts as the court considers appropriate.

(B) Application for allowances. Any person seeking allowances shall file with the court an application which complies in form and content with the provisions of title 11 of the United States Code [11 USCS §§ 101 et seq.] governing applications for allowances under such title [11 USCS §§ 101 et seq.]. A copy of such application shall be served upon SIPC when filed. The court shall fix a time for a hearing on such application, and notice of such hearing shall be given to the applicant, the trustee, the debtor, the creditors, SIPC, and such other persons as the court may designate, except that notice need not be given to customers whose claims have been or will be satisfied in full or to creditors who cannot reasonably be expected to receive any distribution during the course of the liquidation proceeding.

(C) Recommendations of SIPC and awarding of allowances. Whenever an application for allowances is filed pursuant to subparagraph (B), SIPC shall file its recommendation with respect to such allowances with the court prior to the hearing on such application and shall, if it so requests, be allowed a reasonable time after such hearing

within which to file a further recommendation. In any case in which such allowances are to be paid by SIPC without reasonable expectation of recoupment thereof as provided in this Act and there is no difference between the amounts requested and the amounts recommended by SIPC, the court shall award the amounts recommended by SIPC. In determining the amount of allowances in all other cases, the court shall give due consideration to the nature, extent, and value of the services rendered, and shall place considerable reliance on the recommendation of SIPC.

(D) Applicable restrictions. The restrictions on sharing of compensation set forth in section 504 of title 11 of the United States Code [11 USCS § 504] shall apply to allowances.

(E) Charge against estate. Allowances granted by the court, including interim allowances, shall be charged against the general estate of the debtor as a cost and expense of administration. If the general estate is insufficient to pay allowances in whole or in part, SIPC shall advance such funds as are necessary for such payment.

(6) *Disinterestedness.* (A) Standards. For purposes of paragraph (3), a person shall not be deemed disinterested if —

(i) such person is a creditor (including a customer), stockholder, or partner of the debtor;

(ii) such person is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the filing date was the underwriter of any securities of the debtor;

(iii) such person is, or was within two years prior to the filing date, a director, partner, officer, or employee of the debtor or such an underwriter, or an attorney for the debtor or such an underwriter; or

(iv) it appears that such person has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such an underwriter, or for any other reason, an interest materially adverse to the interests of any class of creditors (including customers) or stockholders,

except that SIPC shall in all cases be deemed disinterested, and an employee of SIPC shall be deemed disinterested if such employee would, except for his association with SIPC, meet the standards set forth in this subparagraph.

(B) Hearing. The court shall fix a time for a hearing on disinterestedness, to be held promptly after the appointment of a trustee. Notice of such hearing shall be mailed at least ten days prior thereto to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor, and to the creditors and stockholders of the debtor, to SIPC, and to such other persons as the court may designate. The court may, in its discretion, also require that notice be given by publication in such newspaper or newspapers of general circulation as it may designate. At such hearing, at any adjournment thereof, or upon application, the court shall hear objections to the retention in office of a trustee or attorney for a trustee on the grounds that such person is not disinterested.

(c) SEC participation in proceedings. The Commission may, on its own motion, file notice of its appearance in any proceeding under this Act and may thereafter participate as a party.

(d) SIPC participation. SIPC shall be deemed to be a party in interest as to all matters arising in a liquidation proceeding, with the right to be heard on all such matters, and shall be deemed to have intervened with respect to all such matters with the same force and effect as if a petition for such purpose had been allowed by the court.

(Dec. 30, 1970, P. L. 91-598, § 5, 94 Stat. 1644; May 21, 1978, P. L. 95-283, § 7, 92 Stat. 254; Nov. 6, 1978, P. L. 95-598, Title III, § 308(a)-(f), 92 Stat. 2674, 2675.)

§ 78fff. General provisions of a liquidation proceeding

(a) Purposes. The purposes of a liquidation proceeding under this Act shall be —

(1) as promptly as possible after the appointment of a trustee in such liquidation proceeding, and in accordance with the provisions of this Act —

(A) to deliver customer name securities to or on behalf of the customers of the debtor entitled thereto as provided in section 8(c)(2) [15 USCS § 78fff-2(c)(2)]; and

(B) to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers to the extent provided in this section;

(2) to sell or transfer offices and other productive units of the business of the debtor;

(3) to enforce rights of subrogation as provided in this Act; and

(4) to liquidate the business of the debtor.

(b) Application of title 11 of the United States Code [11 USCS §§ 101 et seq.]. To the extent consistent with the provisions of this Act, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of title 11 of the United States Code [11 USCS §§ 101 et seq., 301 et seq., 501 et seq., 701 et seq., 721 et seq.]. For the purposes of applying such title [11 USCS §§ 101 et seq.] in carrying out this section, a reference in such title [11 USCS §§ 101 et seq.] to the date of the filing of the petition shall be deemed to be a reference to the filing date under this Act.

(c) Determination of customer status. In a liquidation proceeding under this Act, whenever a person has acted with respect to cash or securities with the debtor after the filing date and in a manner which would have given him the status of a customer with respect to such cash or securities had the action occurred prior to the filing date, and the trustee is satisfied that such action was taken by the customer in good faith and prior to the appointment of the trustee, the date on which such action was taken shall be deemed to be the filing date for purposes of determining the net equity of such customer with respect to such cash or securities.

(d) Apportionment. In a liquidation proceeding under this Act, any cash or securities remaining after the liquidation of a lien or pledge made by a debtor shall be apportioned between his general estate and customer property in the proportion in which the general property of the debtor and the cash and securities of the customers of such debtor contributed to such lien or pledge. Securities apportioned to the general estate under this subsection shall be subject to the provisions of section 16(5)(A) [15 USCS § 78*lll*(5)(A)].

(e) Costs and expenses of administration. All costs and expenses of administration of the estate of the debtor and of the liquidation proceeding shall be borne by the general estate of the debtor to the extent it is sufficient therefor, and the priorities of distribution from the general estate shall be as provided in in section 726 of title 11 of the United States Code [11 USCS § 726]. Costs and expenses of administration shall include payments pursuant to section 8(e) and section 9(c)(1) [15 USCS §§ 78fff-2(e), 78fff-3(c)(1)] (to the extent such payments recovered securities which were apportioned to the general estate pursuant to subsection (d)) and costs and expenses of SIPC employees utilized by the trustee pursuant to section 7(a)(2) [15 USCS § 78fff-1(a)(2)]. All funds advanced by SIPC to a trustee for such costs and expenses of administration shall be recouped from the general estate under section 507(a)(1) of title 11 of the United States Code [11 USCS § 507(a)(1)].

(Dec. 30, 1970, P. L. 91-598, § 6, 84 Stat. 1646; May 21, 1978, P. L. 95-283, § 8, 92 Stat. 259; Nov. 6, 1978, P. L. 95-598, Title III, § 308(g), (h), 92 Stat. 2675.)

§ 78fff-1. Powers and duties of a trustee

(a) Trustee powers. A trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under title 11 of the United States Code [11 USCS §§ 101 et seq.]. In addition, a trustee may, with the approval of SIPC but without any need for court approval —

(1) hire and fix the compensation of all personnel (including officers and employees of the debtor and of its examining authority) and other persons (including accountants) that are deemed by the trustee

necessary for all or any purposes of the liquidation proceeding;

(2) utilize SIPC employees for all or any purposes of a liquidation proceeding; and

(3) margin and maintain customer accounts of the debtor for the purposes of section 8(f) [75 USCS § 78fff-2(f)].

(b) Trustee duties. To the extent consistent with the provisions of this Act or as otherwise ordered by the court, a trustee shall be subject to the same duties as a trustee in a case under chapter 7 of title 11 of the United States Code [11 USCS §§ 701 et seq.], including, if the debtor is a commodity broker, as defined under section 101 of such title, the duties specified in subchapter IV of such chapter 7 [11 USCS §§ 761 et seq.], except that a trustee may, but shall have no duty to, reduce to money any securities constituting customer property or in the general estate of the debtor. In addition, the trustee shall —

(1) deliver securities to or on behalf of customers to the maximum extent practicable in satisfaction of customer claims for securities of the same class and series of an issuer; and

(2) subject to the prior approval of SIPC but without any need for court approval, pay or guarantee all or any part of the indebtedness of the debtor to a bank, lender, or other person if the trustee determines that the aggregate market value of securities to be made available to the trustee upon the payment or guarantee of such indebtedness does not appear to be less than the total amount of such payment or guarantee.

(c) Reports by trustee to court. The trustee shall make to the court and to SIPC such written reports as may be required of a trustee in a case under chapter 7 of title 11 of the United States Code [11 USCS §§ 701 et seq.], and shall include in such reports information with respect to the progress made in distributing cash and securities to customers. Such reports shall be in such form and detail as the Commission determines by rule to present fairly the results of the liquidation proceeding as of the date of or for the period covered by such reports, having due regard for the requirements of section 17 of the 1934 Act [15 USCS § 78q] and the rules prescribed under such section and the magnitude of items and transactions involved in connection with the operations of a broker or dealer.

(d) Investigations. The trustee shall —

(1) as soon as practicable, investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business, and any other matter, to the extent relevant to the liquidation proceeding, and report thereon to the court;

(2) examine, by deposition or otherwise, the directors and officers of the debtor and any other witnesses concerning any of the matters referred to in paragraph (1);

(3) report to the court any facts ascertained by the trustee with respect to fraud, misconduct, mismanagement, and irregularities, and to any causes of action available to the estate; and

(4) as soon as practicable, prepare and submit, to SIPC and such other persons as the court designates and in such form and manner as the court directs, a

statement of his investigation of matters referred to in paragraph (1).

(Dec. 30, 1970, P. L. 91-598, § 7, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 260; Nov. 6, 1978, P. L. 95-598, Title III, § 308(i)-(k), 92 Stat. 2675.)

§ 78fff-2. Special provisions of a liquidation proceeding

(a) Notice and claims. (1) *Notice of proceedings.* Promptly after the appointment of the trustee, such trustee shall cause notice of the commencement of proceedings under this section to be published in one or more newspapers of general circulation in the form and manner determined by the court, and at the same time shall cause a copy of such notice to be mailed to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor. Notice to creditors other than customers shall be given in the manner prescribed by title 11 of the United States Code [11 USCS §§ 101 et seq.], except that such notice shall be given by the trustee.

(2) *Statement of claim.* A customer shall file with the trustee a written statement of claim but need not file a formal proof of claim, except that no obligation of the debtor to any person associated with the debtor within the meaning of section 3(a)(18) or section 3(a)(21) of the 1934 Act [15 USCS § 78c(a)(18), (21)], any beneficial owner of 5 per centum or more of the voting stock of the debtor, or any member of the immediate family of any such person or owner may be satisfied without formal proof of claim.

(3) *Time limitations.* No claim of a customer or other creditor of the debtor which is received by the trustee

after the expiration of the six-month period beginning on the date of publication of notice under paragraph (1) shall be allowed, except that the court may, upon application within such period and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian. Any claim of a customer for net equity which is received by the trustee after the expiration of such period of time as may be fixed by the court (not exceeding sixty days after the date of publication of notice under paragraph (1)) need not be paid or satisfied in whole or in part out of customer property, and, to the extent such claim is satisfied from moneys advanced by SIPC, it shall be satisfied in cash or securities (or both) as the trustee determines is most economical to the estate.

(4) *Effect on claims.* Except as otherwise provided in this section, and without limiting the powers and duties of the trustee to discharge obligations promptly as specified in this section, nothing in this section shall limit the right of any person, including any subrogee, to establish by formal proof or otherwise as the court may provide such claims as such person may have against the debtor, including claims for the payment of money and the delivery of specific securities, without resort to moneys advanced by SIPC to the trustee.

(b) Payments to customers. After receipt of a written statement of claim pursuant to subsection (a)(2), the trustee shall promptly discharge, in accordance with the provisions of this section, all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash, by the delivery of securities or the making of payments to or for the account of such customer (subject to the provisions of subsection (d) and

section 9(a) [15 USCS § 78fff-3(a)]) insofar as such obligations are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the filing date. For purposes of this subsection, the court shall, among other things —

(1) with respect to net equity claims, authorize the trustee to satisfy claims out of moneys made available to the trustee by SIPC notwithstanding the fact that there has not been any showing or determination that there are sufficient funds of the debtor available to satisfy such claims; and

(2) with respect to claims relating to, or net equities based upon, securities of a class and series of an issuer which are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee, authorize the trustee to deliver securities of such class and series if and to the extent available to satisfy such claims in whole or in part, with partial deliveries to be made pro rata to the greatest extent considered practicable by the trustee.

Any payment or delivery of property pursuant to this subsection may be conditioned upon the trustee requiring claimants to execute, in a form to be determined by the trustee, appropriate receipts, supporting affidavits, releases, and assignments, but shall be without prejudice to any right of a claimant to file formal proof of claim within the period specified in subsection (a)(3) for any balance of securities or cash to which such claimant considers himself entitled.

(c) Customer related property. (1) *Allocation of customer property.* The trustee shall allocate customer property of the debtor as follows:

(A) first, to SIPC in repayment of advances made by SIPC pursuant to section 9(c)(1) [15 USCS § 78fff-3(c)(1)], to the extent such advances recovered securities which were apportioned to customer property pursuant to section 6(d) [15 USCS § 73fff(d)];

(B) second, to customers of such debtor, who shall share ratably in such customer property on the basis and to the extent of their respective net equities;

(C) third, to SIPC as subrogee for the claims of customers;

(D) fourth, to SIPC in repayment of advances made by SIPC pursuant to section 9(c)(2) [15 USCS § 78fff-3(c)(2)].

Any customer property remaining after allocation in accordance with this paragraph shall become part of the general estate of the debtor. To the extent customer property and SIPC advances pursuant to section 9(a) [15 USCS § 78fff-3(a)] are not sufficient to pay or otherwise satisfy in full the net equity claims of customers, such customers shall be entitled, to the extent only of their respective unsatisfied net equities, to participate in the general estate as unsecured creditors. For purposes of allocating customer property under this paragraph, securities to be delivered in payment of net equity claims for securities of the same class and series of an issuer shall be valued as of the close of business on the filing date.

(2) *Delivery of customer name securities.* The trustee shall deliver customer name securities to or on behalf of a

customer of the debtor entitled thereto if the customer is not indebted to the debtor. If the customer is so indebted, such customer may, with the approval of the trustee, reclaim customer name securities upon payment to the trustee, within such period of time as the trustee determines, of all indebtedness of such customer to the debtor.

(3) *Recovery of transfers.* Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of title 11 of the United States Code (11 USCS §§ 101 et seq.]. Such recovered property shall be treated as customer property. For purposes of such recovery, the property so transferred shall be deemed to have been the property of the debtor and, if such transfer was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding.

(d) Purchase of securities. The trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities based on securities under section 7(b)(1) [15 USCS § fff-1(b)(1)] and for the transfer of customer accounts under subsection (f), in order to restore the accounts of such customers as of the filing date. To the extent consistent with subsection (c), customer property and moneys advanced by SIPC may be used by the trustee to pay for securities so purchased. Moneys advanced by SIPC for each account of a separate customer may not be used to purchase securities to the

extent that the aggregate value of such securities on the filing date exceeded the amount permitted to be advanced by SIPC under the provisions of section 9(a) [15 USCS § fff-3(a)].

(e) Closeouts. (1) *In general.* Any contract of the debtor for the purchase or sale of securities in the ordinary course of its business with other brokers or dealers which is wholly executory on the filing date shall not be completed by the trustee, except to the extent permitted by SIPC rule. Upon the adoption by SIPC of rules with respect to the closeout of such a contract but prior to the adoption of rules with respect to the completion of such a contract, the other broker or dealer shall close out such contract, without unnecessary delay, in the best available market and pursuant to such SIPC rules. Until such time as SIPC adopts rules with respect to the completion or closeout of such a contract, such a contract shall be closed out in accordance with Commission Rule S6(d)-1 as in effect on the date of enactment of this section [enacted May 21, 1978], or any comparable rule of the Commission subsequently adopted, to the extent not inconsistent with the provisions of this subsection.

(2) *Net profit or loss.* A broker or dealer shall net all profits and losses on all contracts closed out under this subsection and —

(A) if such broker or dealer shows a net profit on such contracts, he shall pay net profit to the trustee; and

(B) if such broker or dealer sustains a net loss on such contracts, he shall be entited to file a claim against the debtor with the trustee in the amount of such net loss.

To the extent that a net loss sustained by a broker or dealer arises from contracts pursuant to which such broker or dealer was acting for its own customer, such broker or dealer shall be entitled to receive funds advanced by SIPC to the trustee in the amount of such loss, except that such broker or dealer may not receive more than $40,000 for each separate customer with respect to whom it sustained a loss. With resepct to a net loss which is not payable under the preceding sentence from funds advanced by SIPC, the broker or dealer shall be entitled to participate in the general estate as an unsecured creditor.

(3) *Registered clearing agencies.* Neither a registered clearing agency which by its rules has an established procedure for the closeout of open contracts between an insolvent broker or dealer and its participants, nor its participants to the extent such participants' claims are or may be processed within the registered clearing agency, shall be entitled to receive SIPC funds in payment of any losses on such contracts, except as SIPC may otherwise provide by rule. If such registered clearing agency or its participants sustain a net loss on the closeout of such contracts with the debtor, they shall have the right to participate in the general estate as unsecured creditors to the extent of such loss. Any funds or other property owed to the debtor, after the closeout of such contracts, shall be promptly paid to the trustee. Rules adopted by SIPC under this paragraph shall provide that in no case may a registered clearing agency or its participants, to the extent such participants' claims are or may be processed within the registered clearing agency, be entitled to receive funds advanced by SIPC in an amount greater, in the aggregate, than could be received by the participants if such participants proceeded individually under paragraphs (1) and (2).

(4) *Definition.* For purposes of this subsection, the term "customer" does not include any person who —

(A) is a broker or dealer;

(B) had a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, was part of the capital of the claiming broker or dealer or was subordinated to the claims of any or all creditors of such broker or dealer; or

(C) had a relationship of the kind specified in section 9(a)(5) [15 USCS § 78fff-3(a)(5)] with the debtor.

A claiming broker or dealer shall be deemed to have been acting on behalf of its customer if it acted as agent for such customer or if it held such customer's order which was to be executed as a part of its contract with the debtor.

(f) Transfer of customer accounts. In order to facilitate the prompt satisfaction of customer claims and the orderly liquidation of the debtor, the trustee may, pursuant to terms satisfactory to him and subject to the prior approval of SIPC, sell or otherwise transfer to another member of SIPC, without consent of any customer, all or any part of the account of a customber of the debtor. In connection with any such sale or transfer to another member of SIPC and subject to the prior approval of SIPC, the trustee may —

(1) waive or modify the need to file a written statement of claim pursuant to subsection (a)(2); and

(2) enter into such agreements as the trustee considers appropriate under the circumstances to indemnify any such member of SIPC against

shortages of cash or securities in the costomer accounts sold or transferred.

The funds of SIPC may be made available to guarantee or secure any indemnification under paragraph (2). The prior approval of SIPC to such indemnification shall be conditioned, among such other standards as SIPC may determine, upon a determination of SIPC that the probable cost of any such indemnification can reasonably be expected not to exceed the cost to SIPC of proceeding under section 9(a) and section 9(b) [15 USCS §78fff-3(a), (b)].

(Dec. 30, 1970, P. L. 91-598, § 8, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 261; Nov. 6, 1978, P. L. 95-598, Title III, § 308*(1)*, (m), 92 Stat. 2675.)

§ 78fff-3. SIPC advances

(a) Advances for customers' claims. In order to provide for prompt payment and satisfaction of net equity claims of customers of debtor, SIPC shall advance to the trustee such moneys, not to exceed $500,000 for each customer, as may be required to pay or otherwise satisfy claims for the amount by which the net equity of each customer exceeds his ratable share of customer property, except that —

(1) if all or any portion of the net equity claim of a customer in excess of his ratable share of customer property is a claim for cash, as distinct from a claim for securities, the amount advanced to satisfy such claim for cash shall not exceed $100,000 for each such customer;

(2) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(3) if all or any portion of the net equity claim of a customer in excess of hi' ratable share of customer property is satisfied b' the delivery of securities purchased by the trustee pursuant to section 8(d) [15 USCS § 78fff-2(d)], the securities so purchased shall be valued as of the filing date for purposes of applying the dollar limitations of this subsection;

(4) no advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any net equity claim of a customer who is a general partner, officer, or director of the debtor, a beneficial owner of five per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights), a limited partner with a participation of five per centum or more in the net assets or net profits of the debtor, or a person who, directly or indirectly and through agreement or otherwise, exercised or had the power to exercise a controlling influence over the management or policies of the debtor; and

(5) no advance shall be made by SIPC to the trustee to pay or otherwise satisfy any net equity claim of any customer who is a broker or dealer or bank, other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank, or otherwise, that the net equity claim of such broker or dealer or bank against the debtor arose out of transactions for customers of such broker or dealer or bank (which customers are not themselves a broker or dealer or bank or a person described in paragraph (4)), in which event each such customer of such

broker or dealer or bank shall be deemed a separate customer of the debtor.

To the extent moneys are advanced by SIPC to the trustee to pay or otherwise satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this Act, except that SIPC as subrogee may assert no claim against customer property until after the allocation thereof to customers as provided in section 8(c) [15 USCS § 78fff-2(c)].

(b) Other advances. SIPC shall advance to the trustee —

(1) such moneys as may be required to carry out section 8(e) [15 USCS § 78fff-2(e)]; and

(2) to the extent the general estate of the debtor is not sufficient to pay any and all costs and expenses of administration of the estate of the debtor and of the liquidation proceeding, the amount of such costs and expenses.

(c) Discretionary advances. SIPC may advance to the trustee such moneys as may be required to —

(1) pay or guarantee indebtedness of the debtor to a bank, lender, or other person under section 7(b)(2) [15 USCS § 78fff-1(b)(2)];

(2) guarantee or secure any indemnity under section 8(f) [15 USCS § 78fff-2(f)]; and

(3) purchase securities under section 8(d) [15 USCS § 78fff-2(d)].

(Dec. 30, 1970, P. L. 91-598, § 9, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 265; Oct. 10, 1980, P. L. 96-433, § 1, 94 Stat. 1955.)

§ 78fff-4. Direct payment procedure

(a) Determination regarding direct payments. If SIPC determines that —

(1) any member of SIPC (including a person who was a member within one hundred eighty days prior to such determination) has failed or is in danger of failing to meet its obligations to customers;

(2) one or more of the conditions specified in section 5(b)(1) [15 USCS § 78eee(b)(1)] exist with respect to such member;

(3) the claim of each customer of the member is within the limits of protection provided in section 9(a) [15 USCS § 78fff-3(a)];

(4) the claims of all customers of the member aggregate less than $250,000;

(5) the cost to SIPC of satisfying customer claims under this section will be less than the cost under a liquidation proceeding; and

(6) such member's registration as a broker-dealer under section 15(b) of the 1934 Act [15 USCS § 78o] has been terminated, or such member has consented to the use of the direct payment procedure set forth in this section,

SIPC may, in its discretion, use the direct payment procedure set forth in this section in lieu of instituting a liquidation proceeding with respect to such member.

(b) Notice. Promptly after a determination under subsection (a) that the direct payment procedure is to be used with respect to a member, SIPC shall cause notice of such direct payment procedure to be published in one or more newspapers of general circulation in a form and manner determined by SIPC, and at the same time shall cause to be mailed a copy of such notice to each person who appears, from the books and records of such member, to have been a customer of the member with an open account within the past twelve months, to the address of such person as it appears from the books and records of such member. Such notice shall state that SIPC will satisfy customer claims directly, without a liquidation proceeding, and shall set forth the form and manner in which claims may be presented. A direct payment procedure shall be deemed to commence on the date of first publication under this subsection and no claim by a customer shall be paid or otherwise satisfied by SIPC unless received within the six-month period beginning on such date, except that SIPC shall, upon application within such period, and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian.

(c) Payments to customers. SIPC shall promptly satisfy all obligations of the member to each of it [its] customers relating to, or net equity claims based upon, securities or cash by the delivery of securities or the effecting of payments to such customer (subject to the provisions of section 8(d) and section 9(a) [15 USCS §§ 78fff-2(d), 78fff-3(a)]) insofar as such obligations are ascertainable from the books and records of the member or are otherwise established to the satisfaction of SIPC. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the

date of publication under subsection (b). Any payment or delivery of securities pursuant to this section may be conditioned upon the execution and delivery, in a form to be determined by SIPC, of appropriate receipts, supporting affidavits, releases, and assignments. To the extent moneys of SIPC are used to satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers against the member.

(d) Effect on claims. Except as otherwise provided in this section, nothing in this section shall limit the right of any person, including any subrogee, to establish by formal proof or otherwise such claims as such person may have against the member, including claims for the payment of money and the delivery of specific securities, without resort to moneys of SIPC.

(e) Jurisdiction of Bankruptcy Courts. After SIPC has published notice of the institution of a direct payment procedure under this section, any person aggrieved by any determination of SIPC with respect to his claim under subsection (c) may, within six months following mailing by SIPC of its determination with respect to such claim, seek a final adjudication of such claim. The courts of the United States having jurisdiction over cases under title 11 of the United States Code [11 USCS §§ 101 et seq.] shall have original and exclusive jurisdiction of any civil action for the adjudication of such claim. Any such action shall be brought in the judicial district where the head office of the debtor is located. Any determination of the rights of a customer under subsection (c) shall not prejudice any other right or remedy of the customer against the member.

(f) Discontinuance of direct payment procedures. If, at any time after the institution of a direct payment

procedure with respect to a member, SIPC determines, in its discretion, that continuation of such direct payment procedure is not appropriate, SIPC may cease such direct payment procedure and, upon so doing, may seek a protective decree pursuant to section 5 [15 USCS § 78eee]. To the extent payments of cash, distributions of securities, or determinations with respect to the validity of a customer's claim are made under this section, such payments, distributions, and determinations shall be recognized and given full effect in the event of any subsequent liquidation proceeding. Any action brought under subsection (e) and pending at the time of the appointment of a trustee under section 5(b)(3) [15 USCS § 78eee(b)(3)] shall be permanently stayed by the court at the time of such appointment, and the court shall enter an order directing the transfer or removal to it of such suit. Upon such removal or transfer the complaint in such action shall constitute the plaintiff's claim in the liquidation proceeding, if appropriate, and shall be deemed received by the trustee on the date of his appointment regardless of the date of actual transfer or removal of such action.

(g) References. For purposes of this section, any reference to the trustee in sections 7(b)(1), 8(d), 8(f), 9(a), 16(5) and 16(12) [15 USCS §§ 78fff-1(b)(1), 78fff-2(d), (f), 78fff-3(a), and 78lll(5), (12)] shall be deemed a reference to SIPC, and any reference to the date of publication of notice under section 8(a) [15 USCS § 78fff-2(a)] shall be deemed a reference to the publication of notice under this section.

(Dec. 30, 1970, P. L. 91-598, § 10, as added May 21, 1978, P. L. 95-283, § 9, 92 Stat. 266; Nov. 6, 1978, P. L. 95-598, Title III, § 308(n), 92 Stat. 2675.)

§ 78ggg. SEC functions

(a) Administrative procedure. Determinations of the Commission, for purposes of making rules pursuant to section 3(e)(3) and 13(f) [15 USCS §§ 78ccc(e)(3), 78iii(f)] shall be after appropriate notice and opportunity for a hearing, and for submission of views of interested persons, in accordance with the rulemaking procedures specified in section 553 of title 5, United States Code [5 USCS § 553], but the holding of a hearing shall not prevent adoption of any such rule or regulation upon expiration of the notice period specified in subsection (d) of such section [5 USCS § 553(d)] and shall not be required to be on a record within the meaning of subchapter II of chapter 5 of such title [5 USCS §§ 551 et seq.].

(b) Enforcement of actions. In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this Act and for such other relief as the court may deem appropriate to carry out the purposes of this Act.

(c) Examinations and reports. (1) *Examination of SIPC, etc.* The Commission may make such examinations and inspections of SIPC and require SIPC to furnish it with such reports and records or copies thereof as the Commission may consider necessary or appropriate in the public interest or to effectuate the purposes of this Act.

(2) *Reports from SIPC.* As soon as practicable after the close of each fiscal year, SIPC shall submit to the Commission a written report relative to the conduct of its business, and the exercise of the other rights and powers

granted by this Act, during such fiscal year. Such report shall include financial statements setting forth the financial position of SIPC at the end of such fiscal year and the results of its operations (including the source and application of its funds) for such fiscal year. The financial statements so included shall be examined by an independent public accountant or firm of independent public accountants, selected by SIPC and satisfactory to the Commission, and shall be accompanied by the report thereon of such accountant or firm. The Commission shall transmit such report to the President and the Congress with such comment thereon as the Commission may deem appropriate.

(Dec. 30, 1970, P. L. 91-598, § 11[7](a)-(c), 84 Stat. 1652; May 21, 1978, P. L. 95-283, §§ 9, 10, 92 Stat. 260, 268.)

§ 78hhh. Examining authority functions

Each member of SIPC shall file with such member's examining authority, or collection agent if a collection agent has been designated pursuant to section 13(a) [15 USCS § 78iii(a)], such information (including reports of, and information with respect to, the gross revenues from the securities business of such member, including the composition thereof, transactions in securities effected by such member, and other information with respect to such member's activities, whether in the securities business or otherwise, including customer accounts maintained, net capital employed, and activities conducted) as SIPC may determine to be necessary or appropriate for the purpose of making assessments under section 4 [15 USCS § 78ddd]. The examining authority or collection agent shall file with SIPC all or such part of such information (and such compilations and analyses thereof) as SIPC,

by bylaw or rule, shall prescribe. No application, report, or document filed pursuant to this section shall be deemed to be filed pursuant to section 18 of the 1934 Act [15 USCS § 78r].

(Dec. 30, 1970, P. L. 91-598, § 12[8], 84 Stat. 1653; May 21, 1978, P. L. 95-283, §§ 9, 11, 92 Stat. 260, 268.)

§ 78iii. Functions of self-regulatory organizations

(a) Collection agent. Each self-regulatory organization shall act as collection agent for SIPC to collect the assessments payable by all members of SIPC for whom such self-regulatory organization is the examining authority, unless SIPC designates a self-regulatory organization other than the examining authority to act as collection agent for any member of SIPC who is a member of or participant in more than one self-regulatory organization. If the only self-regulatory organization of which a member of SIPC is a member or in which it is a participant is a registered clearing agency that is not the examining authority for the member, SIPC may, nevertheless, designate such registered clearing agency as collection agent for the member or may require that payments be made directly to SIPC. The collection agent shall be obligated to remit to SIPC assessments made under section 4 [15 USCS § 78ddd] only to the extent that payments of such assessment are received by such collection agent. Members of SIPC who are not members of or participants in a self-regulatory organization shall make payments directly to SIPC.

(b) Immunity. No self-regulatory organization shall have any liability to any person for any action taken or omitted in good faith pursuant to section 5(a)(1) and section 5(a)(2) [15 USCS § 78eee(a)(1), (2)].

(c) Inspections. The self-regulatory organization of which a member of SIPC is a member or in which it is a participant shall inspect or examine such member for compliance with applicable financial responsibility rules, except that —

(1) if the self-regulatory organization is a registered clearing agency, the Commission may designate itself as responsible for the examination of such member for compliance with applicable financial responsibility rules; and

(2) if a member of SIPC is a member of or participant in more than one self-regulatory organization, the Commission, pursuant to section 17(d) of the 1934 Act [15 USCS § 78q(d)], shall designate one of such self-regulatory organizations or itself as responsible for the examination of such member for compliance with applicable financial responsibility rules.

(d) Reports. There shall be filed with SIPC by the self-regulatory organizations such reports of inspections or examinations of the members of SIPC (or copies thereof) as may be designated by SIPC by bylaw or rule.

(e) Consultation. SIPC shall consult and cooperate with the self-regulatory organizations toward the end:

(1) that there may be developed and carried into effect procedures reasonably designed to detect approaching financial difficulty upon the part of any member of SIPC;

(2) that, as nearly as may be practicable, examinations to ascertain whether members of SIPC are in compliance with applicable financial responsibility rules will be conducted by the self-regulatory organizations under appropriate standards (both as to

method and scope) and reports of such examinations will, where appropriate, be standard in form; and

(3) that, as frequently as may be practicable under the circumstances, each member of SIPC will file financial information with, and be examined by, the self-regulatory organization which is the examining authority for such member.

(f) Financial condition of members. The Commission may, by such rules as it determines necessary or appropriate in the public interest and to carry out the purposes of this Act, require any self-regulatory organization to furnish SIPC with reports and records (or copies thereof) relating to the financial condition of members of or participants in such self-regulatory organization.

(Dec. 30, 1970, P. L. 91-598, § 13[9], 84 Stat. 1654; June 4, 1975, P. L. 94-29, § 26, 89 Stat. 163; May 21, 1978, P. L. 95-283, §§ 9, 12 92 Stat. 260, 269.)

§ 78jjj. Prohibited Acts

(a) Failure to pay assessment, etc. If a member of SIPC shall fail to file any report or information required pursuant ot this Act, or shall fail to pay when due all or any part of an assessment made upon such member pursuant to this Act, and such failure shall not have been cured, by the filing of such report or information or by the making of such payment, together with interest and penalty thereon, within five days after receipt by such member of written notice of such failure given by or on behalf of SIPC, is shall be unlawful for such member, unless specifically authorized by the Commission, to engage in business as a broker or dealer. If such member denies that it owes all or any part of the amount specified in such notice, it may after payment of the full amount so specified commence an action against SIPC in the appropriate

United States district court to recover the amount it denies owing.

(b) Engaging in business after appointment of trustee or initiation of direct payment procedure. It shall be unlawful for any broker or dealer for whom a trustee has been appointed pursuant to this Act or for whom a direct payment procedure has been initiated to engage thereafter in business as a broker or dealer, unless the Commission otherwise determines in the public interest. The Commission may by order bar or suspend for any period, any officer, director, general partner, owner of 10 per centum or more of the voting securities, or controlling person of any broker or dealer for whom a trustee has been appointed pursuant to this Act or for whom a direct payment procedure has been initiated from being or becoming associated with a broker or dealer, if after appropriate notice and opportunity for hearing, the Commission shall determine such bar or suspension to be in the public interest.

(c) Concealment of assets; false statements or claims. (1) *Specific prohibited acts.* Any person who, directly or indirectly, in connection with or in contemplation of any liquidation proceeding or direct payment procedure —

(A) employs any device, scheme, or artifice to defraud;

(B) engages in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person; or

(C) fraudulently or with intent to defeat this Act

(i) conceals or transfers any property belonging to the estate of a debtor;

(ii) makes a false statement or account;

(iii) presents or uses any false claim for proof against the estate of a debtor;

(iv) receives any material amount of property from a debtor;

(v) gives, offers, receives, transfers, or obtains any money or property, remuneration, compensation, reward, advantage, other consideration, or promise thereof, for acting or forebearing to act;

(vi) conceals, destroys, mutilates, falsifies, makes a false entry in, or otherwise falsifies any document affecting or relating to the property or affairs of a debtor; or

(vii) withholds, from any person entitled to its possession, any document affecting or relating to the property or affairs of a debtor,

shall be fined not more than $50,000 or imprisoned for not more than five years, or both.

(2) *Fraudulent conversion.* Any person who, directly or indirectly steals, embezzles, or fraudulently, or with intent to defeat this Act, abstracts or converts to his own use or to the use of another any of the moneys, securities, or other assets of SIPC, or otherwise defrauds or attempts to defraud SIPC or a trustee by any means, shall be fined not more than $50,000 or imprisoned not more than five years, or both.

(Dec. 30, 1970, P. L. 91-598, § 14[10]; 84 Stat. 1655; May 21, 1978, P. L. 95-283, §§ 9, 13, 92 Stat. 260, 269.)

§ 78kkk. Miscellaneous provisions

(a) Public inspection of reports. Any notice, report, or other document filed with SIPC pursuant to this Act

shall be available for public inspection unless SIPC or the Commission shall determine that disclosure thereof is not in the public interest. Nothing herein shall act to deny documents or information to the Congress of the United States or the committees of either House having jurisdiction over financial institutions, securities regulation, or related matters under the rules of each body. Nor shall the Commission be denied any document or information which the Commission, in its judgment, needs.

(b) Liability of members of SIPC. Except for such assessments as may be made upon such member pursuant to the provisions of section 4 [15 USCS § 78ddd], no member of SIPC shall have any liability under this Act as a member of SIPC for, or in connection with, any act or omission of any other broker or dealer whether in connection with the conduct of the business or affairs of such broker or dealer or otherwise and, without limiting the generality of the foregoing, no member shall have any liability for or in respect of any indebtedness or other liability of SIPC.

(c) Liability of SIPC and Directors, officers, or employees. Neither SIPC nor any of its Directors, officers, or employees shall have any liability to any person for any action taken or omitted in good faith under or in connection with any matter contemplated by this Act.

(d) Advertising. SIPC shall by bylaw prescribe the manner in which a member of SIPC may display any sign or signs (or include in any advertisement a statement) relating to the protection to customers and their accounts, or any other protections, afforded under this Act. No member may display any such sign, or include in an advertisement any such statement, except in accordance with such bylaws. SIPC may also by bylaw prescribe such minimal requirements as it considers necessary and ap-

propriate to require a member of SIPC to provide public notice of its membership in SIPC.

(e) SIPC exempt from taxation. SIPC, its property, its franchise, capital, reserves, surplus, and its income, shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority, except that any real property and any tangible personal property (other than cash and securities) of SIPC shall be subject to State and local taxation to the same extent according to its value as other real and tangible personal property is taxed. Assessments made upon a member of SIPC shall constitute ordinary and necessary expenses in carrying on the business of such member for the purpose of section 162(a) of the Internal Revenue Code of 1954 [26 USCS § 162(a)]. The contribution and transfer to SIPC of funds or securities held by any trust established by a national securities exchange prior to January 1, 1970, for the purpose of providing assistance to customers of members of such exchange, shall not result in any taxable gain to such trust or give rise to any taxable income to any member of SIPC under any provision of the Internal Revenue Code of 1954 [26 USCS §§ 1 et seq.], nor shall such contribution or transfer, or any reduction in assessments made pursuant to this Act, in any way affect the status, as ordinary and necessary expenses under section 162(a) of the Internal Revenue Code of 1954 [26 USCS § 162(a)], of any contributions made to such trust by such exchange at any time prior to such transfer. Upon dissolution of SIPC, none of its net assets shall inure to the benefit of any of its members.

(f) 15 USCS § 78t(a) not to apply. The provisions of subsection (a) of section 20 of the 1934 Act [15 USCS

§ 78t(a)] shall not apply to any liability under or in connection with this Act.

(g) SEC study of unsafe or unsound practices. Not later than twelve months after the date of enactment of this Act [enacted Dec. 30, 1970], the Commission shall compile a list of unsafe or unsound practices by members of SIPC in conducting their business and report to the Congress (1) the steps being taken under the authority of existing law to eliminate those practices and (2) recommendations concerning additional legislation which may be needed to eliminate those unsafe or unsound practices.

(Dec. 30, 1970, P. L. 91-598, § 15[11], 84 Stat. 1655; May 21, 1978, P. L. 95-283, §§ 9, 14, 92 Stat. 260, 270.]

§ 78lll. Definitions

For purposes of this Act, including the application of the Bankruptcy Act [11 USCS §§ 101 et seq.] to the liquidation proceeding:

(1) Commission. The term "Commission" means the Securities and Exchange Commission.

(2) Customer. The term "customer" of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security, or for purposes of effecting transfer. The term "customer" includes any person who has a claim against the debtor arising out of sales or conversions of such securities, and any person who has deposited cash with the debtor for

the purpose of purchasing securities, but does not include —

(A) any person to the extent that the claim of such person arises out of transactions with a foreign subsidiary of a member of SIPC; or

(B) any person to the extent that such person has a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor, or is subordinated to the claims of any or all creditors of the debtor, notwithstanding that some ground exists for declaring such contract, agreement, or understanding void or voidable in a suit between the claimant and the debtor.

(3) Customer name securities. The term "customer name securities" means securities which were held for the account of a customer on the filing date by or on behalf of the debtor and which on the filing date were registered in the name of the customer, or were in the process of being so registered pursuant to instructions from the debtor, but does not include securities registered in the name of the customer which, by endorsement or otherwise, were in negotiable form.

(4) Customer property. The term "customer property" means cash and securities (except customer name securities delivered to the customer) at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted. The term "customer property" includes —

(A) securities held as property of the debtor to the extent that the inability of the debtor to meet its obligations to customers for thier net equity claims based on securities of the same class and series of an issuer is attributable to the debtor's noncompliance with the requirements of section 15(c)(3) of the 1934 Act [15 USCS § 78*o*(c)(3)] and the rules prescribed under such section;

(B) resources provided through the use or realization of customers' debit cash balances and other customer-related debit items as defined by the Commission by rule;

(C) any cash or securities apportioned to customer property pursuant to section 6(d) [15 USCS § 78fff(d)]; and

(D) any other property of the debtor which, upon compliance with applicable laws, rules, and regulations, would have been set aside or held for the benefit of customers, unless the trustee determines that including such property within the meaning of such term would not significantly increase customer proerty.

(5) Debtor. The term "debtor" means a member of SIPC with respect to whom an application for a protective decree has been filed under section 5(a)(3) [15 USCS § 78eee(a)(3)] or a direct payment procedure has been instituted under section 10(b) [15 USCS § 78fff-4(b)].

(6) Examining authority. The term "examining authority" means, with respect to any member of SIPC (A) the self-regulatory organization which inspects or examines such member of SIPC, or (B) the Commission if such member of SIPC is not a

member of or participant in any self-regulatory organization of if the Commission has designated itself examining authority for such member pursuant to section 13(c) [15 USCS § 78iii(c)].

(7) Filing date. The term "filing date" means the date on which an application for a protective decree is filed under section 5(a)(3) [15 USCS § 78eee(a)(3)], except that —

(A) if a petition under Title 11 of the United States Code [11 USCS §§ 101 et seq.] concerning the debtor was filed before such date, the term "filing date" means the date on which such petition was filed;

(B) if the debtor is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term "filing date" means the date on which such proceeding was commenced; or

(C) if the debtor is the subject of a direct payment procedure or was the subject of a direct payment procedure discontinued by SIPC pursuant to section 10(f) [15 USCS § 78fff-4(f)], the term "filing date" means the date on which notice of such direct payment procedure was published under section 10(b) [15 USCS § 78fff-4(b)].

(8) Foreign subsidiary. The term "foreign subsidiary" means any subsidiary of a member of SIPC which has its principal place of business in a foreign country or which is organized under the laws of a foreign country.

(9) Gross revenues from the securities business. The term "gross revenues from the securities business" means the sum of (but without duplication) —

(A) commissions earned in connection with transactions in securities effected for customers as agent (net of commissions paid to other brokers and dealers in connection with such transactions) and mark-ups with respect to purchases or sales of securities as principal;

(B) charges for executing or clearing transactions in securities for other brokers and dealers;

(C) the net realized gain, if any, from principal transactions in securities in trading accounts;

(D) the net profit, if any, from the management of or participation in the underwriting or distribution of securities;

(E) interest earned on customers' securities accounts;

(F) fees for investment advisory services (except when rendered to one or more registered investment companies or insurance company separate accounts) or account supervision with respect to securities;

(G) fees for the solicitation of proxies with respect to, or tenders or exchanges of, securities;

(H) income from service charges or other surcharges with respect to securities;

(I) except as otherwise provided by rule of the Commission, dividends and interest received on

securities in investment accounts of the broker or dealer;

(J) fees in connection with put, call, and other option transactions in securities;

(K) commissions earned from transactions in (i) certificates of deposit, and (ii) Treasury bills, bankers acceptances, or commercial paper which have a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited, except that SIPC shall by bylaw include in the aggregate of gross revenues only an appropriate percentage of such commissions based on SIPC's loss experience with respect to such instruments over at least the preceding five years; and

(L) fees and other income from such other categories of the securities business as SIPC shall provide by bylaw.

Such term does not include revenues received by a broker or dealer in connection with the distribution of shares of a registered open end investment company or unit investment trust or revenues derived by a broker or dealer from the sale of variable annuities or from the conduct of the business of insurance.

(10) Liquidation proceeding. The term "liquidation proceeding" means any proceeding for the liquidation of a debtor under this Act in which a trustee has been appointed under section 5(b)(3) [15 USCS § 78eee(b)(3)].

(11) Net equity. The term "net equity" means the dollar amount of the account or accounts of a customer, to be determined by —

(A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer (other than customer name securities reclaimed by such customer); minus

(B) any indebtedness of such customer to the debtor on the filing date; plus

(C) any payment by such customer of such indebtedness to the debtor which is made with the approval of the trustee and within such period as the trustee may determine (but in no event more than sixty days after the publication of notice under section 8(a) [15 USCS § 78fff-2(a)]).

In determining net equity under this paragraph, accounts held by a customer in separate capacities shall be deemed to be accounts of separate customers.

(12) Persons registered as brokers or dealers. The term "persons registered as brokers or dealers" includes any person who is a member of a national securities exchange.

(13) Protective decree. The term "protective decree" means a decree, issued by a court upon application of SIPC under section 5(a)(3) [15 USCS § 78eee(a)(3)], that the customers of a member of SIPC are in need of the protection provided under this Act.

(14) Security. The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, any collateral trust certificate, preorganization certificate or subscription, transferable share, voting trust certificate, certificate of deposit,

certificate of deposit for a security, any investment contract or certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or mineral royalty or lease (if such investment contract or interest is the subject of a registration statement with the Commission pursuant to the provisions of the Securities Act of 1933), any put, call, straddle, option, or privilege on any security, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase or sell any of the foregoing, and any other instrument commonly known as a security. Except as specifically provided above, the term "security" does not include any currency, or any commodity or related contract or futures contract, or any warrant or right to subscribe to or purchase or sell any of the foregoing.

(Dec. 30, 1970, P. L. 91-598, § 16[12], 84 Stat. 1656; May 21, 1978, P. L. 95-283, §§ 9, 15, 92 Stat. 260, 271; Nov. 6, 1978, P. L. 95-598, Title III, § 308(o), 92 Stat. 2676; Oct. 13, 1982, P. L. 97-303; § 7, 96 Stat. 1410.)

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In the Supreme Court

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United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
Petitioner,

VS.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit

BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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EDITOR'S NOTE:

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QUESTIONS PRESENTED

The Securities Investor Protection Corporation ("SIPC"), Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated, and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation (the "Trustees") sued Robert G. Holmes, Jr. ("Holmes") and others under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961-68 (1984) ("RICO"), for participating in a scheme to manipulate securities that caused the multi-million dollar failure of two securities firms. The district court granted summary judgment in favor of Holmes and the circuit court reversed. As restated, the Petition for a Writ of Certiorari raises two issues:

1. Did the circuit court err when it held that SIPC and the Trustees do not have to be a "purchaser or seller" of securities to bring an action as a "person injured in his business or property by reason of a violation of section 1962" consisting of "any offense . . . involving fraud in the sale of securities . . . punishable under any law of the United States"? 18 U.S.C. §§ 1964(c), 1961.

2. Did the circuit court err when it held that SIPC and the Trustees presented a triable issue that their "business or property" was "injured . . . by reason of" the conduct of Holmes in league with his co-conspirators in violation of 18 U.S.C. § 1962(d)? 18 U.S.C. § 1964(c).

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No. 90-727

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
Petitioner,

VS.

SECURITIES INVESTOR PROTECTION
CORPORATION, et al.,
Respondents

**On Petition for a Writ of Certiorari
to the United States Court of Appeals
For the Ninth Circuit**

BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

STATUTORY PROVISION INVOLVED

Title 18, United States Code, in relevant part, provides as follows:

§ 1961. Definitions.

As used in this chapter —

> (1) "racketeering activity" means . . . any act . . . indictable under . . . title 18, United States Code: . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), . . . or . . . any offense involv-

ing . . . fraud in the sale of securities, . . . punishable under any law of the United States;

• • •

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

• • •

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity . . .;

§ 1962. Prohibited activities.

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise . . . .

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise . . . .

(c) It shall be unlawful for any person employed by or associated with an enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . .

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b) or (c) of this section.

§ 1964. Civil remedies.

• • •

(c) Any person injured in his business or property by reason of a violation of section 1962 . . . may sue therefor . . . and shall recover threefold the damages he sustains . . . .

Public Law 91-452 Section 904, 84 *Stat.* 947, provides as follows:

Section 904. (a) The provisions of this title shall be liberally construed to effectuate its remedial purposes.

STATEMENT OF THE CASE

Respondents adopt as their statement of the case the introduction and facts set out by the Ninth Circuit in its opinion at 908 F.2d 1463-65:

The district court granted summary judgment in favor of defendant Holmes in this suit brought by the Securities Investor Protection Corporation ("the SIPC") and trustees of defunct stock brokerage firms. The SIPC and the trustees sued to recover losses allegedly sustained as a result of a conspiracy to manipulate the prices of stocks of publicly traded corporations. The district court concluded that the SIPC did not have standing to assert a claim under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO"), when that claim was based on alleged securities violations under section 10(b) of the Securities Exchange Act of 1934

and Rule 10b-5 promulgated thereunder.[1] The district court also determined that the defendant Holmes' acts viewed separately from those of the other alleged coconspirators were not the proximate cause of the losses sustained. We have jurisdiction under Fed. R. Civ. P. 54(b) and 28 U.S.C. § 1291 and we reverse.

Facts

In 1970, Congress established the SIPC pursuant to the Securities Investor Protection Act, codified as amended at 15 U.S.C. §§ 78aaa-78*lll*. The SIPC was created in the wake of the collapse of numerous brokerage houses. It was created to provide greater protection to customers of brokers and dealers and members of national securities exchanges.

The SIPC is a nonprofit corporation. Its membership consists of most registered brokers and dealers. 15 U.S.C. § 78ccc(a). It has the power "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any State, Federal, or other court." 15 U.S.C. § 78ccc(b)(1). The SIPC also has the power to apply for a protective decree from a court of competent jurisdiction and to seek the appointment of a trustee for the liquidation of a broker-dealer member's business when a broker-dealer member fails or is in danger of failing to meet obligations to customers. 15 U.S.C. § 78eee.

In late July 1981, the SIPC instituted liquidation proceedings against two securities brokerages, First State Securities Corp. ("FSSC") and Joseph Sebag,

[1]Section 10(b), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5.

Inc. ("Sebag"). John L. Britton was appointed trustee for the liquidation of FSSC,[2] and Eugene W. Bell was appointed trustee for the liquidation of Sebag (collectively, "the trustees"). In the process of liquidating the brokerages, the SIPC alleges it had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

In July 1983, the SIPC and the trustees filed an action in federal district court against seventy-five defendants, alleging securities fraud in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; a conspiracy under RICO; common law fraud; and breach of fiduciary duty. The SIPC and the trustees alleged in their complaint that from 1964 through July 1981 the defendants engaged in a scheme to manipulate the stock of six companies traded in the over-the-counter market,[3] and that the defendants used FSSC and Sebag as vehicles in furtherance of this scheme. The defendants are officers and directors of the six companies and former principals and employees of FSSC and Sebag.

The SIPC and the trustees allege that the defendants misrepresented the six companies' prospects through statements by company officials, press releases, and financial statements. An illusion of active markets in the six stocks was allegedly maintained

[2]Laurence A. Schroeder is currently the successor trustee for the liquidation of FSSC.

[3]The companies are Aero Systems, Inc., Aerosonics Corp., Bunnington Corp., Creditbank, Inc., Dash Industries, Inc., and Osrow Products Corp.

by misleading transactions in the defendants' accounts, in the brokerages' proprietary accounts, and in the accounts of unsuspecting customers. When the alleged scheme was uncovered, the prices of the stocks fell drastically. Because FSSC and Sebag held large amounts of the stocks in their proprietary accounts, they incurred heavy losses, leading to the liquidation proceedings.

The present appeal is the third to reach this court in this litigation. In *Securities Investor Protection Corp. v. Vigman,* 764 F.2d 1309 (9th Cir. 1985), the district court dismissed four defendants for lack of personal jurisdiction and improper venue. As to lack of personal jurisdiction, we reversed the dismissal of one defendant and remanded the dismissal of another for further consideration. *Id.* at 1316. We also remanded for further proceedings the district court's dismissal of these two defendants on the ground of improper venue. *Id.* at 1318. In *Securities Investor Protection Corp. v. Vigman,* 803 F.2d 1513, 1519-1520 (9th Cir. 1986), we reversed the dismissal of the SIPC's 10-b5 claims.

Robert G. Holmes, Jr., the only defendant involved in this appeal, is the founder, the chief executive officer, the president, and a major shareholder of Aero Systems, Inc. ("Aero"), one of the six companies whose stock was allegedly manipulated. Holmes also was a shareholder in Bunnington Corp. ("Bunnington"), another one of the six companies, during the period of the alleged manipulation. The SIPC and the trustees allege that Holmes participated in a conspiracy with certain other defendants to manipulate the price of Aero and Bunnington stock. They allege that Holmes issued false and misleading press

releases and other public statements regarding a new product Aero was marketing to inflate artificially the price of Aero's stock. Further, they assert that Holmes helped other defendants manipulate the price of Bunnington's stock by purchasing large blocks of Bunnington stock and then selling in small lots, thus creating the appearance of an active trading market. Finally, the plaintiffs allege that Holmes helped conceal FSSC's poor financial position by allowing FSSC to "park"[4] shares of Bunnington stock in Holmes' trading account.

Holmes moved for summary judgment, asserting that the SIPC lacked standing to assert a RICO claim because the SIPC was not a purchaser or seller of securities. Holmes also contended that any conduct he engaged in did not cause the losses which the SIPC and the trustees sustained.

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[4] "Parking" is a mechanism used to evade the net capital requirements of the National Association of Securities Dealers ("NASD"). When a brokerage firm files the required monthly report with the NASD regarding its net capital condition, it must discount in value any stock it holds in its own account (referred to as a "haircut"). To reach technical compliance with its net capital requirements, a brokerage firm "sells" stock from the brokerage's own account to a customer at market price. This avoids the discounting for reporting purposes. Once the brokerage firm has filed its report with the NASD and met its net capital requirement, the firm "buys" the shares back from the customer, usually at the same price at which it sold the stock plus interest.

The SIPC and the trustees allege that Holmes conspired with FSSC to park shares of Bunnington in Holmes' account to allow FSSC to mask its net capital deficiencies in its reports to the NASD. This allegedly allowed FSSC to continue its participation in the overall manipulation conspiracy.

The district court granted Holmes' motion for summary judgment. The district court concluded that genuine issues of material fact existed as to the elements of the RICO claim, including whether Holmes conspired to violate RICO, but it concluded that the SIPC did not meet the purchaser-seller requirement for standing to assert a RICO claim predicated upon violations of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

The district court also concluded that a genuine issue of material fact existed as to whether Holmes' acts, upon which the RICO claim was based, were the *actual cause* of the losses to the SIPC and the trustees, but that there was no genuine issue for trial to dispute the fact that Holmes' acts were not the *proximate cause* of the losses. The district court reached its proximate cause conclusion by isolating Holmes' acts from the acts of other members of the alleged conspiracy, and by applying a "loss causation" requirement to the RICO claim.

The circuit court reversed the grant of summary judgment, holding both that SIPC need not be a purchaser or seller of securities under RICO and that as a conspirator, Holmes is responsible for the acts of others undertaken in furtherance of the illegal agreement. Petitioner now seeks this Court's review.

SUMMARY OF REASONS FOR DENYING THE WRIT

It is not necessary for this Court to review the Ninth Circuit's decision that SIPC need not be a purchaser or seller of securities to maintain claims under RICO. The split in the circuit courts is not sufficiently defined to indicate that review is appropriate; nor have the circuit

courts fully developed the arguments for or against application of the purchaser/seller standing limitation to RICO. Moreover, the Ninth Circuit's ruling was correct as a matter of statutory construction.

Petitioner's second issue regarding causation also is not appropriate for review. The district court clearly found issues of material fact to support Respondents' allegation of a conspiracy to violate RICO and the Ninth Circuit affirmed the long standing rule that conspirators are liable for the acts of others undertaken in furtherance of the agreement. For the foregoing reasons, the Petition for a Writ Certiorari should be denied.[1]

REASONS FOR DENYING THE WRIT

A. The Purchaser/Seller Standing Issue Does Not Require Review By This Court.

1. Review Of The Application Of Purchaser/Seller Limitations To RICO Is Not Yet Ripe.

Petitioner contends that the Ninth Circuit's decision not to read "purchaser-seller" standing limitations into the text of RICO is in conflict with the positions of the Fourth and Eighth Circuits (Petition at 7-8.) While this may be so,[2] the conflict is not ripe for review. *See McCray*

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[1]The Ninth Circuit asserted jurisdiction over Holmes' appeal pursuant to Federal Rule of Civil Procedure 54(b), permitting entry of judgment in favor of one of multiple parties, and 28 U.S.C. Section 1291. The case remains pending in the district court as against the remaining defendants, but has been stayed during proceedings in this Court.

[2]*Compare Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461, 1465-67 (9th Cir. 1990), *and Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir. 1987), *with Brannan v. Eisenstein*, 804

v. New York, 461 U.S. 961, 962-63 (1983) (Stevens, J.) (certiorari denied where issue requires further study); *Maryland v. Baltimore Radio Show, Inc.*, 338 U.S. 912, 918 (1950) (Frankfurter, J.) ("[D]esirable to have different aspect of an issue further illumined by the lower courts[,] ... [as] wise adjudication has its own time for ripening"). Only the decisions of the Fourth and Ninth Circuits represent full-scale treatments of the text, precedent, and policy considerations raised by this Petition. The decisions of the Eleventh and Eighth Circuits are at best cryptic. As such, this Court's review ought to be postponed until, if ever, the basic arguments have been fully made, the positions deliberately taken and fully developed, and the conflict among several circuits has become irreconcilable.

A debate that includes only opening remarks by each side, but no rebuttal, is not ripe for resolution. It would be helpful, for example, to hear from the Second and Seventh Circuits, each of which has extensive expertise in RICO and securities litigation. Indeed, the well-reasoned position of the Ninth Circuit may come to represent the majority view, and the Fourth Circuit may be led to reverse its narrow reading of the statute, making review by this Court unnecessary. *See, e.g., Busby v. Crown Supply, Inc.*, 896 F.2d 833, 840-42 (4th Cir. 1990) (person-enterprise rule under Section 1962(a) abandoned in light of contrary precedent in other circuits).

Petitioner suggests grave consequences from an onslaught of civil RICO litigation. Petitioner's contention is incorrect.

F.2d 1041, 1046-47 (8th Cir. 1986) *and International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987).

First, Congress wanted RICO to apply to both "legitimate" and "illegitimate" enterprises. *H.J. Inc. v. Northwestern Bell Telephone Co.*, 109 S.Ct. 2893, 2902-05 (1989); *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 499 (1985); *United States v. Turkette*, 452 U.S. 576, 580-81 (1981). Second, it is not true that the federal courts are being overwhelmed by civil RICO litigation now[3] or that they would be under the Ninth Circuit's rule. In fact, only approximately 1,000 RICO cases are filed out of a total of 240,000 filings each year. *Myths* at 870. Common law fraud is alleged in approximately 52.7% of these cases, while securities fraud is alleged in approximately 32%.[4] As such, the number of securities-type cases that might be filed as RICO actions could increase at the maximum from approximately 320 to 527 filings. Since approximately 58.6% of RICO suits have an independent basis for federal jurisdiction (*id.*), the increase in new federal litigation probably would not exceed 218 new cases.

These data, moreover, do not fully factor in this Court's efforts to further refine application of the RICO Act. *See H.J. Inc.*, 109 S.Ct. at 2899 (two predicate acts, without more, is insufficient). Even before *H.J. Inc.*, the circuits were properly declining to turn RICO into a general tort statute based on multiple mailings. *See, e.g., Elliott v. Chicago Motor Club Ins.*, 809 F.2d 347, 350 (7th Cir. 1987) ("multiplicity of mailing does not necessarily translate directly into a 'pattern' ") (*quoting Lipin Enterprises Inc. v. Lee*, 803 F.2d 322, 325 (7th Cir. 1986) (Cudahy, J., concurring)). That course of action continues after *H.J.*

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[3]Blakey & Perry, *An Analysis of the Myths that Bolster Efforts to Rewrite RICO*, 43 Vanderbilt. L. Rev. 851, 869-73 (1990) (analysis of docket filings) ("*Myths*").

[4]Blakey & Cessar, *Equitable Relief Under Civil RICO*, 62 Notre Dame L. Rev. 526, 621 (1987) ("*Equitable Relief*").

Inc. Finally, Congress, albeit slowly, is inexorably moving to narrow the scope of civil RICO. *See* S. Rep. No. 101-269, 101st Cong., 2nd Sess. (1990) (reporting S. 438); 6 Civil RICO Rep. 1 (Sept. 25, 1990) (noting reporting of H.R. 5111).

The invitation of Petitioner to this Court to undertake a similar effort is inappropriate. *H.J. Inc.*, 109 S.Ct. at 2905 ("a job for Congress"); *Sedima*, 473 U.S. at 500 ("a form of statutory amendment [in]appropriately undertaken by the courts"); Note, *Civil RICO: The Temptation and Impropriety of Judicial Restriction*, 95 Harv. L. Rev. 1101 (1982). More than a little irony is also present in Petitioner's reliance on *Blue Chip Stamps v. Manor Drug-stores*, 421 U.S. 723, *reh'g denied*, 423 U.S. 884 (1975). *See Id.* at 748: "[T]he Judiciary *may not circumscribe a right which Congress has conferred* because of any disagreement it might have with Congress about the wisdom of creating sc expansive a liability." (emphasis added).

2. The Ninth Circuit's Holding Regarding The Purchaser/Seller Issue Was Correct, Further Indicating That Review Is Not Required.

Although not binding here, Respondents submit that the Ninth Circuit was correct in its interpretation of RICO, and that the Fourth Circuit was in error.[5] Interpretation of RICO begins with its text; structure as well as language is important. *Russello v. United States*, 464 U.S. 16, 22-23 (1983); *Turkette*, 452 U.S. at 587. Title 18 Section 1962 is enforced by private suits through 18

[5]The Trustees, in their capacities as purchasers of the manipulated securities, meet the purchaser/seller rule under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The Trustees' standing to present their claims has not been disputed in this case. The purchaser/seller issue is raised only as to SIPC.

U.S.C. Section 1964(c), which provides that "[a]ny person injured in his business or property by reason of a violation of 1962" may sue. The definition of "person" includes "any entity." 18 U.S.C. § 1961(3). The plain text of RICO, therefore, does not impose "purchaser or seller" limitations. "[T]he plaintiff only has standing if . . . he has been injured in his business or property by the conduct constituting the violation . . . But the statute requires no more than this." *Sedima,* 473 U.S. at 496-97. The private right under RICO is express; judicial standing limitations, therefore, are improper. *Blue Chip Stamps*, 421 U.S. at 748-49.[6]

The language of RICO is plain, and this Court's teachings preclude judicially imposed limitations. Nevertheless, the Fourth Circuit in *Zepkin* held otherwise. Conceding that Congress did not *expressly* limit RICO by "purchaser or seller" limitations and noting the absence, not only of "purchaser-seller" language, but also of Section 10(b)'s "in connection with" causation standard, the *Zepkin* court held that explicit statutory language was required in RICO to overcome judicially imposed limitations on private actions under Rule 10b-5. *Zepkin*, 812 F.2d at 152. *Zepkin* is fundamentally misguided, misreads the statutory scheme of RICO, and reflects bad policy. *See Fedorenko v. United States*, 449 U.S. 490, 513 (1981) (The Court is "not at liberty to imply a condition which is opposed to the explicit terms of the statute. . . . To [so] hold . . . is not to construe the Act but to amend it.")

[6]Respondents' First Amended Complaint also included mail and wire fraud among the alleged predicate offenses under 18 U.S.C. Sections 1961(1) and 1962. The district court, without analysis, extended its "purchaser/seller" holding on offenses involving fraud in the sale of securities to these other predicate acts.

(*quoting Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21, 38 (1934)).

First, *H.J. Inc.* and *Sedima* squarely hold that RICO's express text, structure, and legislative history, not silence in its text or legislative history, control the interpretation of RICO. *H.J. Inc.*, 109 S.Ct at 2899; *Sedima*, 473 U.S. at 495 n.13. RICO must be liberally construed, and its remedial purposes are to be enhanced, not retarded. *Sedima*, 473 U.S. at 497-98. The Fourth Circuit rejects the liberal construction clause for its narrow interpretation of the statute. Indeed, *Zepkin* does not even address 18 U.S.C. Section 1964, the civil provision that, in fact, *expressly* deals with standing, injury, and causation. As this Court noted in *Sedima*, it was expressly to avoid judicially created standing limitations on RICO's remedies that the legislation was enacted outside of the antitrust statutes. *Id.* at 498. By reading such limitations into RICO, the Fourth Circuit "create[s] exactly the problems Congress sought to avoid." *Id.* at 499.

Rule 10b-5 standing limitations are inapplicable to RICO on another ground. The purchaser/seller limitation of Rule 10b-5 is imposed only for private civil actions. The violation of Rule 10b-5 that constitutes a predicate act under RICO, however, is a *criminal* securities fraud. "[O]ffense . . . punishable . . ." "obviously refers to [the] criminal" provisions of the securities statutes. *Trane Co. v. O'Connor Securities*, 718 F.2d 26, 29 (2d Cir. 1983). *See* Section 32(a) of the Securities Exchange Act of 1934, 48 Stat. 904 ("willfully violates").[7]

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[7]The standard of Section 32(a) is not limited by "purchaser-seller" limitations. *United States v. Charnay*, 537 F.2d 341, 349 n.11 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976) ("In a criminal prosecution, the standing problem is . . . not present and Rule 10b-5 is applicable. . . .") *See also United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979) (*Blue Chip Stamps* does not limit criminal provision); *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983) ("It is only because the judiciary . . . created a private cause of action . . . that standing . . . has become a pivotal issue.")

Plaintiffs under RICO, especially public benefit corporations such as SIPC, act as private prosecutors.[8] Had Congress wanted to impose "purchaser-seller" standing limitations on this civil enforcement mechanism, it could have done so with appropriate language. Congress was well aware of the overlap between RICO and the securities statues, as the point was specifically drawn to its attention.[9] As such, forcing civil RICO into a purely private law model, as the Fourth Circuit does in *Zepkin*, misconceives civil RICO's important *public* law functions.[10]

No language in the mail or wire fraud statutes, moreover, warrants reading into them, as the district court did, the "purchaser or seller" limitations. Nor does *Zepkin* address standing under the mail or wire fraud statutes, as it only involved a Rule 10b-5 claim. 812 F.2d at 151 (standing under other claims not decided). The

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[8]Respondents also add that in another context, this Court considered the provisions of SIPA. *SIPC v. Barbour*, 421 U.S. 412, 415-18 (1975). *See also In re Executive Secs. Corp.*, 702 F.2d 406, 410 (2d Cir. 1983), where the Second Circuit stated that both SIPC and the trustees appointed under SIPA vindicate important public purposes.

[9]Blakey, *RICO Civil Action in Context*, 68 Notre Dame L. Rev. 237, 272-73 (1982).

[10]*See generally* Chayes, *Forward: Public Law Litigation and the Burger Court*, 96 Harv. L. Rev. 4, 5 (1982) (classic model of private dispute resolution contrasted with contemporary model of public grievances against aggregates of power); *Id.* at 8-26 (inappropriate private law standing limitations analyzed); Chayes, *The Role of the Judge in Public Law Litigation*, 89 Harv. L. Rev. 1281 (1976).

purpose of the two statutes, taken together, is to prohibit schemes to defraud that utilize, in varying circumstances, the mails or interstate wire communications. *Parr v. United States,* 363 U.S. 370, 389 (1960). The statutes say nothing about "purchasers or sellers."

Only two elements need come together to establish a mail or wire fraud violation: a scheme to defraud and the use of the mails or interstate wires to execute it. *Pereira v. United States,* 347 U.S. 1, 8-9 (1954). A "scheme to defraud" is not limited to common law concepts of fraud. *Durland v. United States,* 161 U.S. 306, 314 (1896). *See generally United States v. Bohonus,* 628 F.2d 1167, 1171 (9th Cir.), *cert. denied,* 447 U.S. 928 (1980) ("non-technical standard") (*citing United States v. Louderman,* 576 F.2d 1383, 1389 (9th Cir.), *cert. denied,* 439 U.S. 896 (1978)).

Conceptual difficulties may arise, however, when parties or courts "confus[e] mail fraud with common law fraud" (*Armco Indus. Credit Corp. v. SLT Warehouse Co.,* 782 F.2d 475, 481 (5th Cir. 1986)), since (1) neither "purchaser or seller" standing limitations, (2) materiality or justifiable and detrimental reliance, nor (3) misrepresentation or omission are elements that circumscribe the substantive definition of a "scheme to defraud" in the mail and wire fraud statutes incorporated into RICO.[11] Accordingly, neither mail nor wire fraud's concepts of "scheme to defraud" under RICO are limited by "purchaser or seller" standing or similar common law requirements. As such, the district court's summary judgment cannot be legally justified. It is not necessary to decide the case to reach the alleged conflict between the Fourth and Ninth Circuits claimed to exist under securities fraud as a predicate offense. The Petition for a Writ of Certiorari, therefore, should be denied. *See The Monrosa v. Carbon Black Export, Inc.,* 359 U.S. 180, 183-84, *reh'g denied,* 359 U.S. 999 (1959).

[11] *Brandenburg v. Seidel,* 859 F.2d 1179, 1187 (4th Cir. 1988) (no detrimental reliance required for mail or wire fraud); *Armco Indus. Credit Corp.,* 782 F.2d at 481-82 (no justifiable or detrimental reliance required for mail fraud); *McLendon v. Continental Group, Inc.,* 602 F. Supp. 1492, 1506-10 (D.N.J. 1985) (RICO scheme to defraud: noting inapplicability of misrepresentation or omission in "scheme to defraud").

B. Review Of The Scope Of Conspiratorial Liability Under RICO Is Not Warranted.

Petitioner contends that the circuit court's decision holding that a conspirator is liable for his co-conspirator's conduct ought to be reviewed by this Court. In doing so, Petitioner argues that his acts as a conspirator must have caused the plaintiffs' harm and that there are no district court findings that any act in furtherance of the conspiracy to manipulate the six companies' securities caused the collapse of the brokerage firms. (Petitioner's Brief, pp. 16-22.) Petitioner not only misstates the law; he also misrepresents the record below and conveniently *fails to acknowledge his own admissions* before the District Court.

1. There Is No Split In The Circuits On The Issue Of Whether Conspirators Are Liable For The Acts Of Their Co-Conspirators.

Petitioner identifies no decision of this Court or of a circuit court holding that conspirators are not liable for the injury-causing acts of their co-conspirators. As such, review by this Court is not required. In fact, the general rule at common law and under various federal statutes fully supports the Ninth Circuit's decision.

Under the common law, once a conspiracy is shown, any injury inflicted by an overt act in furtherance of the

conspiracy is civilly actionable. *Nalle v. Oyster,* 230 U.S. 165, 182 (1913) ("[T]he well-settled rule is that . . . [a] civil action lies for conspiracy [if] . . . an overt act . . . results in damage to the plaintiff."); *Kashi v. Gratsos,* 790 F.2d 1050, 1054 (2d Cir. 1986) (common law fraud) (liable for all damages caused, not just personal involvement); *Hooks v. Hooks,* 771 F.2d 935, 944 (6th Cir. 1985); *Halberstam v. Welch,* 705 F.2d 472, 487 (D.C. Cir. 1983) (common law fraud); Restatement (Second) of Torts, § 876(a) (1977) ("pursuant to a common design"); *id.* comments a, b ("conspiracy"). Conspiracy is not the basis of the claim; it is the injury that flows from an overt act that forms the basis for compensation. The rule is universally followed without difficulty in the lower courts. *See, e.g., United States v. Excellair, Inc.,* 637 F. Supp. 1377, 1388 n.7 (D. Colo. 1986); *Weise v. Reisner,* 318 F. Supp. 580, 583 (E.D. Wis. 1970); Restatement (Second) of Torts, § 876, comment b ("agreement is not enough . . . acts of a tortious character in carrying it into execution"). Litigation under federal statutes follows a similar and uniform path. *See, e.g., Griffin v. Breckenridge,* 403 U.S. 88, 103 (1971) (Civil Rights Act, 42 U.S.C. § 1985 (3)).[12] Accordingly, nothing here merits this Court's review.

2. Petitioner's Attempt To Distance Himself From His Co-Conspirators Does Not Warrant The Court's Review.

Petitioner also argues that "there was no finding of a genuine dispute concerning whether Holmes was a con-

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[12] *Lenard v. Argento,* 699 F.2d 874, 883 (7th Cir.) (Civil Rights Act, 42 U.S.C. § 1985(3)) *cert. denied,* 464 U.S. 815 (1983); *Lawrence v. Acree,* 655 F.2d 1319, 1324 (D.C. Cir. 1981) (same); *Ostrofe v. H.S. Crocker Co.,* 740 F.2d 739, 744 (9th Cir. 1984) (antitrust), *cert. dismissed,* 469 U.S. 1200 (1985); *Beltz Travel Service, Inc. v. Int'l Air*

spirator in any conspiracy that caused the brokerage firms' losses . . . . Conspicuous by its absence is any finding by the District Court or ruling by the Ninth Circuit that there is a genuine issue of fact whether Holmes was a co-conspirator in the conspiracy that caused the brokerage firms' loss." (Petitioner's Brief, pp. 17-18.) It is unclear whether Petitioner now contends he was not a conspirator or whether he argues that no acts in furtherance of the agreement caused the loss.

Petitioner cannot maintain there was no finding that he conspired to violate RICO. In fact, the district court, in its revision of Petitioner's proposed Order Granting Summary Judgment (RICO Claims), *specifically found* that "there is [a] genuine dispute regarding material facts with respect to the following issues, i.e., whether . . . Robert G. Holmes, Jr. conspired to violate RICO Sections

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Transport Ass'n, 620 F.2d 1360, 1366-67 (9th Cir. 1980) (antitrust) ("[R]egardless of the nature of [defendants'] own actions."); *Donahue v. Pendleton Woolen Mills, Inc.,* 633 F. Supp. 1423, 1437 (S.D.N.Y. 1986) (antitrust); *Int'l Longshoremen's Union v. Juneau Spruce Corp.,* 189 F.2d 177, 189-90 (9th Cir. 1951) (Taft-Hartley Act, 29 U.S.C. § 187(b)), *aff'd on other grounds,* 342 U.S. 237 (1952); *Simeon v. T. Smith & Son, Inc.,* 852 F.2d 1421, 1430-32 (5th Cir.) (Jones Act) (46 U.S.C. § 688) (not limited to percentage of fault), *reh'g en banc denied,* 860 F.2d 1255 (1988), *cert. denied,* 109 S.Ct. 3156 (1989) *Lyon v. Ranger III,* 858 F.2d 22, 28 (1st Cir. 1988) (concert of action under maritime law) ("not only for his own acts but also for the acts of others with whom he acts in concert."); *Ferguson v. Omnimedia, Inc.,* 469 F.2d 194, 197 (1st Cir. 1972) (securities fraud) (liable even though not engaged in act causing harm); *Herpich v. Wilder,* 430 F.2d 818, 819 (5th Cir. 1970) ("[H]aving allegedly joined the conspiracy and taken steps to assure its success, [defendant] may be held responsible for the acts of his co-conspirators in furtherance of their scheme."), *cert. denied,* 401 U.S. 947 (1971).

1962(a); 1962(b); or 1962(c)."[13] (C.R. 1317, Petitioner's Appendix, p. 45a.) The district court then *did* find genuine issues of material fact supporting the Respondents' allegation that there was a conspiracy to violate RICO and that Petitioner was a member of that conspiracy. (C.R. 1343, Petitioner's Appendix, p. 45a.) The circuit court, which reviewed the record *de novo,* noted that the district court's finding of genuine issues of material fact to support a conspiracy was inconsistent with the finding that Petitioner was not legally responsible for the acts of his co-conspirators. 908 F.2d at 1468-69. The circuit court therefore reversed, correctly noting that all conspirators are liable for the acts of their co-conspirators undertaken in furtherance of the illegal agreement. 908 F.2d at 1469.

Petitioner also apparently argues that there is no finding of a genuine issue of fact whether the conspiracy involving Holmes caused Respondents' loss. Petitioner's argument is surprising in that Peitioner argued before the district court, that the acts of others[14] brought about the manipulation of Bunnington and Aerosonics stock and that those acts were the cause of the losses to SIPC and the Trustees. (C.R. 1281, Appendix p. A-7.)

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[13]Holmes' proposed order, submitted to the district court, originally read "there is no evidence that Robert G. Holmes, Jr. conspired to violate RICO Sections 1962(a); 1962(b); or 1962(c)." The district court disagreed with Petitioner's proposed order and struck the phrase "there is no evidence that", leaving its finding that SIPC met its burden under Federal Rule of Civil Procedure 56 in demonstrating that Holmes conspired with others to violate RICO. (C.R. 1343, Petitioner's Appendix, p. 45a.)

[14]The acts of Holmes' co-defendants were factually linked to Holmes and the Aerosonics and Bunnington stock manipulations by the evidence before the district court.

Petitioner himself affirmatively alleged below that the price of Bunnington Corporation stock, one of the manipulated securities, was "artificially inflated" and that the large concentration of Bunnington and Aerosonics securities in the FSSC and Sebag inventory accounts was a "substantial cause of the demise of the brokerage houses." (C.R. 1281, Appendix, p. A-7.) Respondents directly tied Holmes to the manipulation of Bunnington stock by introducing evidence showing that Holmes participated with, and provided substantial assistance to, his co-conspirators.[15]

Petitioner, however, never argued before the district or circuit courts that the conspiracy did not cause the loss. Petitioner, in fact, argued precisely the opposite; *i.e.*, that the manipulation of securities by others in furtherance of the illegal conspiracy caused the brokerage firms' demise.

Petitioner's efforts before this Court to distance himself from his co-conspirators are unavailing. As a conspirator, Holmes is responsible in damages for those acts, whether he committed them in person or not. "'[A] conspiracy [is] not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole.'" *Beltz Travel Serv., Inc. v. Int'l Air Transp. Ass'n,*

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[15]Holmes' own acts in furtherance of the conspiracy to conduct the enterprise's affairs and thereby manipulate the six securities included, *inter alia*: (1) manipulating the price of Aero Systems stock by issuing materially false and misleading press releases; (2) assisting the brokerage firms to obtain a higher price for Aero Systems stock, thereby bankrolling the Bunnington and Aerosonics manipulations with proceeds from the sale of Aero Systems stock; (3) purchasing Bunnington stock in large blocks while selling only in small lots to create the appearance of a widespread market for Bunnington stock when, in fact, no such market existed; and (4) "parking" Bunnington stock to mask FSSC's net capital deficiency. (C.R. 1310, Appendix, pp. B-1 to B-37.)

620 F.2d 1360, 1366 (9th Cir. 1980), quoting *United States v. Patten*, 226 U.S. 525, 544 (1913). The circuit court, taking the district court's finding of a genuine issue of material fact supporting Respondents' allegation that Holmes participated in the conspiracy, held that "if the district court properly concluded that there was a genuine issue as to whether Holmes conspired to violate RICO, the district court erred in granting Holmes' motion based on a conclusion that his conduct alone did not proximately cause the injuries alleged." 908 F.2d at 1469. There is no conflict in the circuits on this important legal principle; neither is this Court's guidance needed to further reinforce the longstanding rule that co-conspirators are legally responsible for the acts of their confederates or, for that matter, their own acts in furtherance of the conspiracy itself. Therefore, this Court's attention to the Petition is not required and the writ of certiorari should not be granted.

CONCLUSION

For these reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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CASE NO. CV 83-4742-AWT(Tx)

United States District Court

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, et al.,

Defendants.

AND CONSOLIDATED ACTIONS.

NOTICE OF MOTION AND MOTION OF DEFENDANT ROBERT G. HOLMES, JR. FOR SUMMARY JUDGMENT ON ISSUE OF CAUSATION; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on October 17, 1988, at __ o'clock a.m. or as soon thereafter as counsel can be heard, in the courtroom of the Honorable A. Wallace Tashima, United States District Judge, 312 North Spring Street, Los Angeles, California, defendant Robert G. Holmes, Jr. will move for summary judgment on all

claims brought against him by Plaintiff Securities Investor Protection Corporation and Plaintiffs Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Inc. and Lawrence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation.

This Motion for Summary Judgment is made pursuant to Rule 56 of the Federal Rules of Civil Procedure, on the grounds that the uncontroverted facts and controlling authorities on the issue of loss causation entitle Holmes to judgment as a matter of law.

This Motion for Summary Judgment is based upon this Notice of Motion, the attached Memorandum of Points and Authorities in Support Thereof, the Statement of Uncontroverted Facts and Conclusions of Law filed concurrently herewith, the Exhibits to Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment on Issue of Causation and Declaration of Richard P. Walker filed concurrently herewith, and such oral argument as may be presented by counsel at the time of the hearing.

Dated: December , 1990

JACK I. SAMET
RICHARD P. WALKER
BUCHALTER, NEMER, FIELDS &
YOUNGER
A Professional Corporation

By _____
Richard P. Walker
Attorneys for Defendant
Robert G. Holmes, Jr.

MEMORANDUM OF POINTS AND AUTHORITIES

I.

INTRODUCTORY STATEMENT

This motion for summary judgment on the issue of causation (the "Motion") is brought by Robert G. Holmes, Jr. ("Holmes"), who is the founder, president and chief executive officer of Aero Systems, Inc. ("Aero Systems"), a Miami-based avionics firm. Both Aero Systems in its corporate capacity and Holmes in his individual capacity are named as defendants in the *SIPC, et al. v. Vigman, et al.* action (the "action"). This Motion is brought to adjudicate the claims asserted by plaintiff Securities Investor Protection Corporation ("SIPC") and plaintiffs Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Inc. ("Sebag") and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation ("FSSC") ("Trustees"), and is inapplicable to the claims asserted by the plaintiff class in the action.

The proposition this Motion intends to establish can be simply stated: Robert Holmes did not cause the damages alleged by SIPC and the Trustees, because he did not cause Sebag or FSSC to fail, or cause them to fail to comply with applicable net capital requirements. If Sebag or FSSC had not failed, SIPC and the Trustees would not have incurred any of the claimed expenses for which recovery is sought in this action (payment of customer claims and administrative expenses in the liquidation proceedings of Sebag and FSSC). Since Holmes did not cause Sebag or FSSC to fail, his alleged actions could not have been the proximate or legal cause of SIPC's damages. For similar reasons, since Holmes did not cause Sebag or FSSC to fail, the Trustees are not entitled to

recover against Holmes for destruction of the business or good·vill of those firms. Since no genuine issue of fact exists that Holmes caused the losses complained of, he cannot be legally responsible for the damages. Based on the uncontroverted facts and the controlling authorities, Holmes is entitled to judgment as a matter of law.

II.

STATEMENT OF FACTS

On July 21, 1981, all trading by FSSC was halted for violation of net capital requirements under Securities and Exchange Commission Rules 15c-3-1 and 15c-3-3. (*See* Uncontroverted Fact No. 1 of concurrently filed Statement of Uncontroverted Facts and Conclusions of Law (hereinafter "U.F. __").) On the same date, all trading by Sebag was halted for violation of the same net capital rules (U.F. 3). On July 24, 1981, SIPC, acting pursuant to the provisions of the Securities Investor Protection Act of 1970 (15 U.S.C. § 78 *et seq.*) ("SIPA"), obtained a protective decree regarding the bankruptcy estate of FSSC, as a consequence of which a trustee named by SIPC was appointed to liquidate the business of FSSC, to pay customers of FSSC monies from the bankruptcy estate and monies advanced by SIPC, and to perform certain other duties set forth in SIPA (U.F. 2). On July 27, 1981, SIPC obtained a protective decree regarding the bankruptcy estate of Sebag, as a consequence of which a trustee named by SIPC was appointed with similar duties as the trustee for the estate of FSSC (U.F. 4) In all, SIPC, through the Trustees, claims to have been damaged in the amount of at least $4.0 million ($4,000,000) in performing its duties liquidating the estate of FSSC and paying FSSC's customers pursuant to authority granted to SIPC and the Trustees by SIPA

(U.F. 6). For the estate of Sebag, SIPC claims vastly higher damages exceeding at least $26.2 million ($26,200,000) (U.F. 5).

This action was brought by SIPC and the Trustees (hereinafter "Plaintiffs") against Joseph Lugo ("Lugo") and other principals of FSSC and Sebag, and against numerous corporations whose stocks had been traded by these brokerage houses, and principals of those corporations, purportedly to recover sums Plaintiffs claim to have expended in liquidating the estates and paying the customers of FSSC and Sebag.

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V.

PLAINTIFFS' CAUSATION ALLEGATIONS DO NOT RAISE A GENUINE ISSUE OF FACT

A. Plaintiffs' Loss Causation Theory

For purposes of this Motion, it is uncontroverted that the liquidation of FSSC and Sebag resulted in the expenditure of sums which Plaintiffs are seeking to recover as damages in this action, and that FSSC and Sebag were liquidated because of their net capital deficiencies (U.F. 1-6). It is, then, necessary to determine whether a genuine issue for trial exists as to whether Holmes in some way caused the net capital deficiencies of FSSC and Sebag.

Plaintiffs' loss causation theory against Holmes is set forth in Plaintiffs' Responses to Third Set of Interrogatories Propounded by Defendant Robert G. Holmes, Jr. ("Plaintiffs' Interrogatory Responses"), a copy of which is annexed as Exhibit "3" to the concurrently filed Exhibits to Motion of Defendant Robert G. Holmes, Jr. for

Summary Judgment on Issue of Causation (hereinafter "Exhibit __ hereto"), which is incorporated herein by reference. In these interrogatory responses, Plaintiffs incorporate by reference a list of allegedly false and misleading statements issued by Holmes which allegedly artificially inflated the price of Aero Systems stock. Assuming solely for the purpose of this Motion (but without admitting) that Plaintiffs' allegations are true and that Holmes did manipulate the price of Aero Systems stock, the relevant question is, was this alleged manipulation the legal cause of the brokerage houses' net capital deficiencies? If not, did Holmes engage alone, or with others, in any other conduct which was the legal cause of the failure of the brokerage firms?

If a manipulation of Aero Systems stock had caused the brokerage firms to fail, one would expect to see large quantities of Aero Systems stock in the inventories of FSSC and Sebag at the time they ceased doing business, and one would also expect to see the price of Aero Systems stock immediately and precipitously drop when they ceased doing business, as a result of the market for Aero Systems stock being controlled and dominated by the brokerage houses and its price being maintained at an artificially inflated level. Indeed, with certain other issuers who are defendants in this action and whose stock was traded by FSSC and Sebag, this was precisely the case. In closing inventories, FSSC had 33,443 shares (U.F. 7) and Sebag had 73,640 shares (U.F. 8) of Bunnington Corporation stock. Bunnington stock immediately dropped in price from $10⅜ per share to $2½ per share within three days after the brokerage houses were closed (U.F. 9). Similarly, FSSC had 33,022 shares (U.F. 10) and Sebag had 226,910 shares (U.F. 11) of Aerosonic Corporation stock in closing inventories. Aerosonic stock also dropped in price substantially, from $11¼ per share

to $5½ per share, within three days after the brokerage houses were closed (U.F. 12).

The National Association of Securities Dealers ("NASD"), in conducting "autopsy" investigations of the cause of the failure of FSSC and Sebag, concluded that *the large concentration of artificially inflated Bunnington and Aerosonic stock in FSSC's and Sebag's closing inventories was a substantial cause of the demise of the brokerage houses* (U.F. 16; *see* NASD report regarding FSSC, Exhibit 4 hereto: "Shortly after [FSSC's] withdrawal . . . , NASDAQ quotes in Bunnington and Aerosonic fell drastically . . . the decline in market value of inventory positions . . . resulted in a negative net worth . . . A review of inventory positions . . . discloses that . . . the firm began carrying positions which were clearly excessive relative to its capital . . . . " (*Id.*, pp. 1-3); *see also*, NASD report regarding Sebag, Exhibit 5 hereto: "The demise of Joseph Sebag, Inc. appears to be a result of inadequate supervision of a registered representative. Net capital and 15c-3 problems stemmed from the buildup of firm inventory generated from unauthorized customer transactions." *Id.* at p. 4.) The report regarding Sebag stated that these unauthorized transactions were in the securities of "Aerosonics, Bunnington, and Osrow." *Id.* at p. 2.))

CASE NO. CV 83-4742-AWT (Tx)
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United States District Court

CENTRAL DISTRICT OF CALIFORNIA

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AND CONSOLIDATED ACTIONS.

Case No. CV 83-4742-AWT (Tx)
(Consolidated Cases)

STATEMENT OF BACKGROUND AND FACTS

[Filed Concurrently with Memoranda of Points and Authorities in Opposition to Holmes' Motions for Summary Judgment]

[Filed Concurrently with Plaintiffs' Statement of Genuine Issues]

I.

INTRODUCTION

The entire thrust of Defendant Robert G. Holmes, Jr.'s ("Holmes") Motion for Summary Judgment is that the conduct of Defendant Joseph A. Lugo, Jr. ("Lugo") and other defendants were independent forces for which Holmes cannot be accountable. The facts, as hereinafter

set forth, show that Holmes is not only culpable, but along with defendants Seymour Vigman ("Vigman"), Isadore Diamond ("Diamond"), Martin Blumenthal ("Blumenthal"), Lugo and Rodger Garrity ("Garrity"), was one of the principal characters in the scheme to manipulate Aero Systems, Inc. ("Aero Systems") and prices of other over-the-counter securities.

Lugo did not act alone. Rather, the scheme, as will be shown, required and had participants each with distinct roles and responsibilities, with each profiting in his own way, and each contributing to the collapse of First State Securities Corporation ("FSSC") and Joseph Sebag Incorporated ("Sebag").

II.

STATEMENT OF BACKGROUND AND FACTS

A. HOLMES IS LIABLE FOR DAMAGE CAUSED BY THE MANIPULATIVE SCHEME

As more fully set forth below, Holmes was a long-time friend and confidant of Lugo and Vigman. His relationships with Lugo and Vigman enabled him to successfully manipulate Aero Systems and Bunnington stocks. More importantly, however, the Aero Systems manipulation was only a component of a larger scheme to manipulate six different securities. The manipulative schemes culminated with the demise of FSSC and Sebag, thus causing harm to the Trustees and SIPC.

The manipulated securities were Aerosonic, Aero Systems, Bunnington, Creditbank, Dash and Osrow. Holmes' involvement with the grand scheme included the following acts: (1) the manipulation of Aero Systems' stock which benefitted Vigman, who sold out large positions at the precise moment that false press releases caused the price

to escalate. Lugo then resold the Aero Systems stock which harmed FSSC, when Lugo used profits from Aero Systems sales to increase FSSC's inventory position in Bunnington and Aerosonic stock, in a further attempt to manipulate those stocks for the benefit of Holmes, among others; (2) the utilization of proceeds from the sale of Aero Systems stock at manipulated prices to purchase Bunnington stock, when Vigman failed to demand immediate payment. This created a false cash supply at FSSC, enabling Lugo to buy up Bunnington and Aerosonic stock, thereby creating the appearance of market activity when, in fact, there was no *bona fide* market activity in Bunnington or Aerosonic stock; (3) the direct participation in a manipulation of Bunnington stock through the dissemination of a false and misleading press release to a stock broker; (4) the direct manipulation of Bunnington stock through a pattern of trading consisting of purchasing Bunnington stock at FSSC in relatively large blocks, and selling the stock at other brokerage houses in small increments to create the appearance of a wellspread market that did not exist; (5) the parking of 5,000 shares of Bunnington stock at a crucial time when Lugo needed to get Bunnington stock off FSSC's books thereby enabling FSSC to stay in business past the point of a net capital deficiency; (6) the agreement of Holmes to allow his company, Aero Systems, to serve as a retail outlet for a computer marketed by Dash Industries, thereby enabling Dash Industries to make false and misleading statements regarding its business and prospects.

Plaintiffs submit that Holmes was a knowing participant in the manipulative scheme to inflate the price of all six securities. Holmes' knowledge of the scheme's scope and complexity is not only evident in the acts identified above, but can also be inferred from his long-standing relationships with other players in the scheme, and the

personal benefit he realized from marketing securities. Those relationships with his co-defendants are described below.

Plaintiffs seek to prove that the course of Holmes' conduct, stretching back to the mid 1960's, shows a method of operation that became highly sophisticated by 1980-1981. Further, the relationships of many years and acts of many years ago indicate the formation of a conspiracy to manipulate securities that continues to this day. Moreover, many of the activities outlined below are predicate acts under the Racketeer Influenced and Corrupt Organizations Act.

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K. THE CD-3000 WAS USED BY HOLMES, VIGMAN AND OTHERS BY USE OF FALSE STATEMENTS, TO CREATE INVESTOR INTEREST IN AERO SYSTEMS

1. Aero Systems Acquired the "World Wide Marketing Rights" to the CD-3000

The CD-3000 "Fuel Management Computer" was designed as a "pilot aid" (Hayden pp. 17-18) for general aviation aircraft operators (*e.g.*, twin Cessnas, commuter planes, etc.) (Hayden p. 21). The CD-3000 was not originally designed as a fuel savings device (Hayden p. 134), despite the fact that Holmes built an advertising campaign around the device as a system for saving fuel (Hayden p. 136).[47] In fact, the CD-3000 displays gross aircraft weight, fuel remaining, and is not a "computer" in any real sense. The CD-3000 is no more useful for fuel

[47]Hayden thought of the device more of a range extender than as a fuel savings device (Hayden pp. 134-135). Thus, the CD-3000 wasn't "designed" to "save fuel" as Holmes claimed later.

saving than an aircraft manufacturer's performance chart (Davies pp. 149-150).[48]

Holmes claims that he first heard about the CD-3000 from Charles Hayden ("Hayden") of Colt Electronics, Inc. ("Colt") in February or March 1980 (Holmes pp. 10-12).

Holmes had a "personal desire" to do something with the CD-3000 (Holmes pp. 29-30).[49] Vigman shared Holmes' enthusiasm for the CD-3000 (Holmes p. 31). Holmes discussed with Vigman the possibility of merger between Aero Systems and Colt (Holmes p. 16). However, Vigman advised Holmes not to buy Colt, but to purchase the rights to the CD-3000 instead (Holmes p. 30).

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2. The proper market for the CD-3000 was limited to business jets

The CD-3000 was the idea and invention of Hayden, employed by Colt (Hayden, p. 17). Hayden was an experienced business jet pilot and had a lengthy history in the aircraft industry (*Id.*, pp. 11-18). He had been a member of the National Business Aircraft Association since its inception in 1949 (*Id.*, p. 261).

Hayden handled the marketing for Colt (*Id.*, pp. 137-138). He believed the market for the CD-3000 would be small (*Id.*). He believed that the market was very limited for other than business jets (*Id.*, p. 69).

[48]Continental Airlines' pilots rejected the CD-3000 since "the computer wasn't doing anything different than what one of the flight crew members would do with a calculator" (Kightlinger, pp. 29-30).

[49]It is the opinion of John Torkelsen, one of plaintiffs' experts, that the stock of Aero Systems was manipulated (Torkelsen Decl. ¶ 16).

Further, Hayden believed the CD-3000 was not of practical use in the general aviation field (*Id.* p. 69).[51] Hayden was aiming at the business aircraft market (*Id.*, pp. 21-22). He wanted to keep the price low enough to attract commuter aircraft and he did not believe that the CD-3000 would ever be a seller in the airline market (*Id.*). He did not pursue the airline market because he saw no potential for sales in it (*Id.*, pp. 139-142). He had looked at the airlines and found a complete lack of interest (*Id.*). He had conducted market studies by conversing with pilots from all over the world (*Id.*, p. 52). Hayden estimated that Colt would get CD-3000 sales involving 10% of the existing executive aircraft in operation, and approximately 25% of the new executive type aircraft being sold (*Id.*, pp. 53-54). The estimate was based on his examination of the market and of the planes in the market (*Id.*). He estimated that sales would be 35-50 per year (*Id.*).[52]

Holmes told Hayden how much he wanted to market the CD-3000 under the Aero System's name (*Id.*, p. 61), and that Holmes had expressed that he thought it "would be a great thing for the airlines" (*Id.*, p. 64).[53] However, Hayden told Holmes before Holmes acquired the rights to

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[51]The term "general aviation aircraft" refers generally to all aircraft other than commercial aircraft. (*See* Hayden, p. 69).

[52]Hayden's forecasting proved both right and wrong. First, he was right about the market; only 7 were sold by Holmes to airlines between April 1980 and December 1987 and *none* were sold to general aviation aircraft (Exh. 5285). Hayden was wrong, however, about how many would be sold. In eight years, Aero System sold only *90* CD-3000s, which is only a little over *11* per year — less than one a month (Exh. 5284).

[53]Holmes admits that before he signed the agreement with Colt, no CD-3000 had been sold to any commercial airline (RFA 260).

the CD-3000 that he (Hayden) did not think it would ever be a big seller (*Id.*, p. 137). Hayden expressed extreme skepticism about the arrangement (*Id.*, pp. 61-62). Hayden told Holmes in 1980 that Airlines' maximum efficiency occurs at between Mach .74 and .76 but that airlines operate between Mach .80 and .82 despite fuel considerations (*Id.*, p. 144). Hayden told Holmes that airlines know how to save fuel but don't because of time constraints and that sales to airlines "was a complete and total dead issue." (*Id.*, p. 144; 267-268).[54] Also, Lynn told Holmes that the application of the CD-3000 was limited to business jets, and was only "remotely" applicable to commercial aircraft (Lynn, p. 91). When Holmes sensed Hayden's unenthusiastic reception, Holmes offered Hayden 5,000 shares of Aero Systems stock "if you don't raise too much fuss with Bob (Lynn) to go ahead with this." (Hayden, p. 62).[55]

Aside from the idea of selling to the airlines, Holmes never expressed a marketing concept to Hayden except

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[54]Holmes admits that Hayden "may" have told Homes that the commercial airlines were not the proper market for the CD-3000 (Holmes p. 284). Holmes admitted that international airlines were his principal target (Holmes p. 113). He also admitted that he knew that the device could not be sold to single engine planes (Holmes pp. 85-86).

[55]While Aero Systems' files are replete with "incentives" or "inducements" to airlines to buy or test the device (facts which are too numerous to detail here, but facts with which Aero Systems will not disagree), the bribe to Hayden is only one of two actual known bribes made by Holmes in his desperate efforts to sell the CD-3000 to an airline. In the late spring of 1982, Holmes attempted to bribe Frederick Lind, the Vice President of Engineering and Quality Assurance of Continental Airlines, to enter into "a joint advertising campaign" (Lind Declaration). While this occurred after collapse of the brokerage houses, it is compelling evidence to show that the airlines had not been the proper market, and that Holmes knew it.

that Holmes intended to sell through dealers (*Id.*, pp. 69-70).

Indeed, before Holmes acquired the "worldwide distribution rights" to the CD-3000 he had had no market study done (Holmes, p. 43).[56] Holmes could have cared less; the real reason that Holmes wanted the rights to the CD-3000 was best expressed by Holmes to Hayden when Holmes was trying to induce Hayden to accept 5,000 Aero Systems shares for not raising a "fuss": "Mr. Holmes expressed to me that, *when he made his pitch with all his people, that the stock would go up sharply*" (Hayden, pp. 179-180) (Emphasis added).

Holmes, however, didn't listen, didn't investigate the market and didn't care what the inventor knew the market for the CD-3000 to be. He had a different agenda.

3. Holmes, Vigman and Others Started to Make the "Pitch" and Misrepresented the Capabilities and the Market of the CD-3000

   a. Holmes and Vigman Immediately Began Selling the Device to the Stock Market: They Used Porter LeVay & Rose

Rather than immediately investigate the market for the CD-3000 because of Hayden's caution, or even try to sell

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[56]Holmes testified that he didn't need a market survey (Holmes, p. 2077). He should have done one, a point that is made quite clearly by Robert Litle, "Special Representative, Aero Systems Aviation Corp" in his memorandum to Holmes dated August 21, 1981 (Exhibit 3869). Litle told Holmes that he has "continued my market analysis of airline customers" and that, while the survey "is not yet complete" fully 65% out of 407 aircraft "cannot be fitted with the CD-3000 at this time" (*Id.*). Litle joined Aero Systems on June 21, 1981 (Exh. 8005), was with Aero Systems for two years and his title was approved by Aero Systems (Holmes, p. 2082).

the device to the airlines, Holmes and Vigman immediately set out to "sell" the CD-3000 to the stock market.

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   b. Vigman Was Heavily Involved With Holmes in the Promotion and Publicity Program for the CD-3000

PLR started its publicity campaign for Holmes.[60] Its activities included, *inter alia*, introducing Aero Systems to the financial community, preparing and distributing releases to the financial community and the business, financial and trade press, placing articles in the financial publications, arranging conferences with financial columnists, updating market makers and discussing Aero Systems with numerous members of and analysts in the financial community (Exhs. 953; 959; 971; 972; 973; 978; 991; 994; 999; 1004; 1007 and 1008).

Shortly after the first press release on April 1, 1980, Vigman and Holmes didn't like the kind of exposure the CD-3000 was getting. Porter prepared a memo to Holmes[61] as to how PLR would handle Aero Systems releases in response to Vigman and Holmes' "rather strong comments about our system, the way we were

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[60]PLR's distribution process included sending all releases to the Wall Street Journal office in Atlanta to get on the Dow system, and were distributed to Reuters, the New York Times and onto the PR Newswire. They were also mailed out to a mailing list made up of brokers and money managers (Porter, pp. 55-56).

[61]Porter wrote Holmes that all releases were to be prepared by PLR from information supplied by Aero System, then reviewed by Aero System and released by PLR with Holmes' approval (Exhibit 956). Porter testified that this procedure was followed (Porter p. 59, ll. 16-18). Thus, PLR released nothing without Holmes' approval and Holmes is personally responsible for the releases and their content. Holmes frequently sent the releases to Vigman for review (Vigman p. 443-444).

making releases, and if I am not mistaken, this was because they felt the release on the CD-3000 did not get enough pick-up in the media" (Porter p. 58; Exh. 956).

Porter had a number of discussions with Vigman about PLR's promotion of Aero Systems stock and the CD-3000 (Exh. 953, p. 407-0098; Exh. 973, p. 407-0002). Vigman and Porter began to have words with each other because of Vigman's discontent with the way the material was distributed, and Porter kept telling Vigman that Vigman wasn't the client (Porter, p. 58, ll. 19-25). Vigman threatened Porter that he, Vigman, was "...a rather large shareholder and I have a lot invested in this company." (*Id.*, p. 59,).[62] Porter told Vigman that he wouldn't discuss it with him but would go through Holmes, but then things started to get rocky. Porter had problems with Holmes because of the "back-biting that Sy Vigman started to do in our firm." (*Id.*, p. 59). Holmes also told Porter that Vigman was unhappy. (*Id.*, p. 59).

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[62]Vigman also privately told Garrity that he, Vigman, was either the first, second or third largest shareholder of Aero Systems (Garrity, p. 23). Vigman privately told Eiseman that he was the largest shareholder of Aero Systems (Eiseman, pp. 79-80, 11/22/85). Plaintiffs have been unable to locate any public disclosure by Holmes or Aero Systems of Vigman's substantial stock holdings in Aero Systems, of Bigman's criminal past, of his extraordinary close association with Holmes, of his claim of being a director of Aero Systems or his pervasive control and influence over Holmes. Indeed, his shadowy presence is hidden by public disclosures to the contrary. In Bunnington's Form 8-K for March 31, 1978 relating to the Springwater sale to Bunnington, Vigman publicly disclaimed owning any Aero Systems stock and told the public that he didn't control Nettie Vigman's 206,925 shares, his two childrens' 120,000 shares or his son-in-law's 236,925 shares (a total of 11.49% of Aero Systems) (Exh. 4105). Note surprisingly, Holmes certified that the Vigmans were not a control group. (*Id.*).

After Porter told Vigman that he wouldn't deal with Vigman, Holmes called Porter and told Porter that Vigman wanted to talk to Porter about what PLR was doing (*Id.*, pp. 91-92). Porter was in the position that since Holmes demanded that Porter talk to Vigman, he did it. (*Id.*). Vigman wanted to know what PLR was going to do for the next several months for Aero Systems "to get the company more exposure" (*Id.*). Porter told Vigman that there were no specifics because he was waiting for dates from the financial community for Holmes to take him on the road to meet brokers (*Id.*). Vigman told Porter that he, Vigman, wanted to make sure that PLR wasn't letting down in their activity "... because (Vigman) *wanted the stock higher* because he thought it was worth a hell of a lot more than it was at this particular time" (*Id.* (emphasis added)).[63]

In a July 1980 conversation, Vigman told Porter that he was following Porter's activities, knew what Porter was doing and was reviewing it (Porter, p. 100). Vigman warned Porter: "I am watching what you are doing (Porter p. 101)."[64]

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[63]Aero System's stock price had gone from a low of $2.78 bid/$3.25 ask in April 1980 to a high of $4.00 bid/4¼ ask in July, 1980 (Foley Decl. ¶ 136).

[64]It's very apparent that Holmes *wouldn't* move without Vigman's approval. Holmes told Porter in about July that he, Holmes, was sending copies of PLR's monthly activities reports to Vigman (Porter, p. 100; Holmes, p. 324).

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2. Holmes, Vigman and Porter, LeVay & Rose Issue False Press Releases

c. April through June 1980

Holmes was responsible for the preparation, content and distribution of Aero Systems' press releases (Holmes, p. 3025). Nothing went out from the company without Holmes' approval (see fn. 61, *supra*). Holmes discussed press releases with Vigman (Vigman, pp. 443-444); he sent press releases to Lugo (Holmes, pp. 109-276). There is no evidence anywhere that Holmes ever modified, changed or retracted any press release, news article, quotation, shareholder letter, annual report or other public document, once that item had been publicly disseminated.[70]

Holmes' very first press release on April 1, 1980 regarding the CD-3000 (Holmes, pp. 658; Exh. 947) states that "The potential market for this much needed new product includes all multi-engine jet, turbo prop and piston aircraft in the world." Thus, Holmes included all of the world's airlines and all of the world's general aviation aircraft in his "potential" market, having done no market study, having no test results and having been told by the inventor that the market Holmes described to the public is not the market for the product.[71] Holmes also states

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[70]Holmes testified that he tried it once, but that there's no way "to get these things changed" (Holmes pp. 379-380).

[71]Both Vigman and Holmes gave input to Porter for the press release (Porter, p. 38) Vigman and Holmes told Porter that the CD-3000 was "designed to reduce fuel consumption by 15%" (Porter, p. 47) and was reflected in the first draft of Porter's first press release (Exhibit 948). There is no basis anywhere for a claim of 15% fuel savings. In fact, at the time of the release, neither Holmes nor

that he plans to market through a "selective network of dealers. Holmes didn't sign up his first dealer for the CD-3000 until September 14, 1981 (Exhibit 8001), eighteen months after he signed the CD-3000 agreement.

On April 23, 1980 (a day after the final agreement was signed between Colt and Aero Systems), Holmes announced that Aero Systems planned to lease the unit "to commercial and business aircraft operators . . . in exchange for a percentage of actual fuel savings" (Exh. 5203). Holmes then stated that "airlines alone will spend more than $30 billion for fuel this year" (*Id.*) The obvious effect sought was that Aero Systems would get, by its leases, that percentage of the $30 billion of fuel saved (Holmes, pp. 105-106). By analyzing Exhibit 5284 which lists all CD-3000 sales and the price paid, through November 1987, it is clear that Aero Systems never entered into any such lease. There was no public announcement that Aero Systems' "plan" was not implemented.

On April 28, 1980 Holmes prepared and sent a letter to Aero Systems' shareholders which states, *inter alia:*

1. "[W]e are very pleased . . . to inform you of a very exciting new development that could be the most significant event in our history."

2. "[W]e are entering an exciting new market . . ."

3. "[P]resent business jet users have indicated fuel savings to be in the area of 10%."

Colt *had* any empirical written test results concerning what or what not the CD-3000 would save (Lynn, pp. 87-88; Holmes, pp. 46-47), and Holmes knew this (Lynn, pp. 89-90). The actual first press release didn't include any reference to any alleged fuel savings. The fact that Holmes and Vigman told Porter that the device saved 15% fuel, however, clearly shows the two of them creating "percentages" out of whole cloth.

4. "[O]ur initial market includes installation in the 50,000 plus multi-engine jet, turbo prop and piston aircraft currently in operation . . ."

5. "[W]e are currently discussing a leasing proposal with one of the major air carriers . . . in exchange for a percentage of actual fuel cost savings."

6. "[T]he potential savings could be a fantastic amount since the world's airlines are expected to spend more than $30 billion for fuel this year, a third of that amount by the U.S. Airlines."

7. "[W]e are thrilled with the added potential of this exciting new high technology product that could be greater than everything we have done throughout our entire history." (Holmes, p. 108; Exh. 5204)

The non-existent "market" identified by Holmes consisted of over 50,000 aircraft of all kinds through the world. There are no facts that Holmes possessed that every aircraft in the world could or would use the CD-3000.[72] Holmes testified that he merely pulled the figure out of Jane's All the World Aircraft (Holmes p. 109). However, there is still no support for Holmes' claim that all the world's aircraft could or would use the device (Declaration of Davies, ¶¶ 3-5). Further, Holmes doesn't disclose that Colt's capacity to produce the CD-3000 is

[72]In fact, Davies testified that general aviation aircraft operators (*e.g.* twin piston, turbo-prop, etc.) would not be interested in the CD-3000 because of its high relative cost (Davies, p. 107), because the cost of fuel is a very small part of the cost of small plane ownership (Davis, p. 69), and because fuel quantity, fuel flow, and gross weight information is available with less expensive devices (Davies, p. 107). And, as Airlift International's Robert Sovacool observed, all new generation jets have more exotic fuel management systems as original equipment (Sovacool, pp. 24-25; *See also* Davies Declaration, ¶¶ 3-5).

extremely limited.[73] Holmes doesn't disclose Colt's reservations as to the CD-3000's limited market appeal, or the inventor's warning that airlines won't use it.

i. *Holmes' Claim That The CD-3000 Saved 10% Fuel Consumption Was False*

Holmes' representation that "business jet users have indicated fuel savings to be in the area of 10%" was false and known to be false at the time it was published.

Holmes admits that there were no written test results of the CD-3000 before he signed the agreement with Colt (Holmes, pp. 46-47). He never received *any* written test results from anyone at Colt (Holmes, p. 48). Holmes admits that the first written test results of any tests on the CD-3000 he or Aero Systems received were in July of 1981 (Holmes pp. 444; 1910-1911; Exh. 1039).

Holmes claims that Lynn and Hayden of Colt *told* him that fuel savings were in the area of 10% (Holmes, p. 117), and that Hayden had told him that Smith (a pilot for Landis Tool) was "getting about 10%" (Holmes, p. 120).

However, Lynn denies that there are or ever were any empirical test results from the CD-3000, or that he ever gave any to Holmes (Lynn, pp. 110-111). Lynn doesn't even recall any customer telling him that there was a percentage fuel savings by using the CD-3000 (Lynn,

[73]Lynn testified that in 1979-1980 Colt had about 10 people of whom three were in production (Lynn, p. 20). In 1980, Colt had only 7,500 square feet and "probably five" people in production (Lynn, p. 21). Colt maintained a "very small" inventory of three to five CD-3000s, and after the Aero System agreement they produced CD-3000s on an "as needed" basis (no inventory was maintained) (Lynn, pp. 57-58). It took Colt three (3) months to produce a CD-3000 from date of order and, all things being equal, Colt could only have produced "several hundred" per year (Lynn, p. 58-59).

p. 31). Lynn never even knew of a percentage savings or fuel maximization, nor did anyone else to his knowledge (Lynn, pp. 28-29). As Lynn stated: "We have no idea what the fuel management computer can save a person in economy" (Lynn, p. 28). Lynn does not recall any discussions with Holmes or Vigman during his March 1980 trip to Miami related to percentage of fuel savings, and at that time there were no test results (Lynn, pp. 87-88). Hayden does not remember "ever saying 10%" (Hayden, p. 42).

Lynn says that Hayden was bandying about the 10% savings numbers, but that there was no test data to support it (Lynn, pp. 89-90), and if percentage figures were passed on to Holmes, Holmes was told that there was no test data to support them (Lynn, p. 101). Lynn further testified that any percentage figure was "pure speculation" and Holmes was told that it was (Lynn, pp. 100-101).

Smith (a pilot at Landis Tool, one of the two business jet operators who had installed the CD-3000 before Aero Systems entered into the agreement with Colt) never represented to anyone at Aero Systems or to anyone on behalf of Aero Systems that fuel savings were possible with the CD-3000 (Smith, p. 40). As a matter of fact, Landis Tool bought the device because it provided more information; they did not buy it to conserve energy, and never used it to conserve energy (Smith, pp. 45-47).

There is no evidence anywhere that Holmes obtained testimonials from "business jet users" that the device saves 10% of fuel before Holmes made that claim in his public announcements.[74]

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[74]The totality of the shareholder letter is not only abnormally hyperbolic, but gives the potential stock purchasers the distinct impression that Aero System, by its "leasing" arrangement to a U.S. airline, would garner earnings equivalent to at least 10% of 10 billion dollars (one third of the $30 billion spent on fuel by the world's airlines).

ii. *Holmes Failed To Disclose Significant Limitations On The CD-3000's Capabilities And Usefulness*

Holmes also failed to disclose to the public the technical capabilities, or lack thereof, of the CD-3000. Holmes failed to disclose that:

(1) Reservations expressed by the inventor and manufacturer regarding the market Holmes was claiming (Hayden pp. 21-22; 141; Lynn, pp. 90-91);

(2) The use of the CD-3000 is very limited. The CD-3000 only is capable of use on the "cruise" portion of the flight, and thus the interest of any airline depended on the "block times" of the airlines' flight schedules.[75]

(3) At the time of the agreement between Colt and Aero Systems, the CD-3000 was not capable of being used on aircraft weighing over 100,000 pounds. (Lynn, pp. 114-116) and was not available in a model for such use until six (6) months after the agreement was signed (*Id.*).[76]

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[75](Hayden pp. 267-268; Exh. 2406).

[76]Virtually all of the commercial airlines and all cargo carriers operated in the time frame from April 1980 to July of 1981 operated at gross weights in excess of 100,000 pounds. (Declaration of Davies, ¶ 2). These aircraft included the following makes and models: Lockheed L-100, L-1011; McDonnell Douglas DC-8, DC-9, DC-10; Boeing 707, 727, 737, 747. *See also* Holmes Response to RFA 652. The CD-3000 couldn't be installed on aircraft in excess of 100,000 pounds until at least September, 1980 (Exh. 2413).

(4) Prior to the sale of the CD-3000 the FAA had to issue a Supplemental Type Certificate ("STC") for use of the device on any given type aircraft for which it was purchased. (Sovacool, p. 56). From the time of the application until the STC is obtained can be from three to six months (Hayden, pp. 34-35).[77]

(5) The use of the device would slow a commercial jet down and that commercial airlines, as Hayden warned are tied to a tight schedule and would not adopt a device that interfered with that schedule;[78]

(6) Use of the device depended heavily on pilot acceptance and, as pilot Smith said, in order to utilize the device, one would have to operate outside the flight manual; "Flight manual is Bible. You don't ever do that" (Smith, pp. 36-38);[79]

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[77]Once an application for an STC is made, a FAA inspector must issue a Type Inspection Authorization, and then a FAA inspector has to test the unit for safety and compatibility with that specific type of plane (Hayden, pp. 30-31). After all of these steps are completed, then the FAA will, in time, issue the STC (*Id.*). Only two types of business jets had CD-3000 STC's at the time Holmes signed the agreement with Colt (RFAs 167-168). In fact, only four STC's had been issued prior to mid-1982 (Exh. 2402).

[78]*e.g.*, American Airlines advised Holmes in (August 6, 1981) that they considered time to be more critical to their operation than fuel savings. (Holmes, p. 2154; Exh. 3882).

[79]Roy Johanson, Aero System's VP-Marketing, who reported directly to Holmes (Johanson, pp. 13-14), testified that the CD-3000 was less successful with airlines than business jets due to poor pilot acceptance (Johanson, pp. 77-78). Pilots were not inclined to use the CD-3000 because of their cockpit work load. Johanson discussed these opinions with Holmes, but Holmes thought he could overcome lack of pilot acceptance through "marketing" (Johanson, pp. 80-82).

(7) The lack of capabilities of Colt to manufacture the CD-3000 in the gross numbers of the "market" that Holmes was leading the public to believe existed for the device.[80]

On the same day of Holmes' shareholder letter the same material was published by the National Quotations Bureau, Inc. (Exh. 116).[81]

On June 9, 1980, Holmes caused to be published an advertisement in Barron's which said "Initial results from business jet users indicate fuel savings to be in the area of 10%" (Holmes, p. 1695; Exh. 3806)[82]

d. July 1980

During April, May and June 1980, Aero Systems stock price remained fairly level from a low 2⅞ bid/3¼ ask to 4 bid/4⅜ ask (Foley Decl. ¶ 135). It's during this time that Holmes and Vigman were expressing dissatisfaction with PLR's program.

On July 1, 1980 PLR prepared and sent Holmes a draft of a "proposed fact file" which was "intended to outline

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[80]*See* footnote 73, *supra*.

[81]Holmes admits that he periodically sent information to the Grinde Organization (NQB publisher), but does not know if he sent this to the Grinde Organization (Exh. 116; Holmes pp. 135-137).

[82]The use by Holmes of the plural "users" is not just disingenuous but is a deliberate misstatement calculated to deceive the public into thinking that the business jet market was crowded with the devices. Holmes only claims to have spoken to Smith of Landis Tool (*supra*, p. 62) and Lynn and Hayden of Colt (*supra*, p. 62). Smith (who denies he told Holmes anything about a 10% savings) is the *only* business jet "user" who could have been Holmes' source. Further, by use of "initial results," Holmes is telling the public that there were some tests conducted on the CD-3000 giving "initial results." There were no tests and no "initial results."

Aero's operations succinctly for members of the financial community" (Porter, p. 74; Exh. 969). Holmes redrafted the "fact file" and sent it back to Porter. (Porter, p. 76; Exh. 969, pp. 407-0563-0566). Porter redrafted it again, taking out some of what Holmes had inserted and finalized it (Porter, p. 77; Exh. 969, pp. 407-0567-0573). The "fact file" and Holmes' revisions are very significant.

First, Holmes reiterates the false claim that "initial results from business jet users indicate fuel savings to be in the area of 10%" and the false claim that the initial market for the device is "50,000 + multi-engine jet, turbo prop and piston aircraft . . ." These misrepresentations stayed in the final "fact file."

Second, Holmes added that "As of June 30 (1980) Aero Systems met the final requirement of the Federal Reserve Board to qualify its stock for sale on margin and expects to be included in the next qualified list to be published in October. This factor alone should greatly enhance the value of the stock" (Exh. 969 at p. 407-0565).[83] This was included in the final "fact file" except for the last sentence (*Id.*, 407-0561); while not expressly said to the public, the last sentence clearly shows that qualifying for margin was part and parcel of Holmes, Vigman and Lugo's carefully conceived plan to raise the Aero Systems stock price without any underlying economic justification.

Third, Holmes adds "We see Aero Systems as the best buy in the market today for capital appreciation and would not be surprised to see the value of this stock triple before the end of this year" (*Id.*, p. 407-0565). While this was muted substantially by Porter in the final version

[83]The Federal Reserve Board approved Aero Systems' stock for sale on margin in early October, 1980 (Exh. 123).

(*Id.*, p. 407-0573), Holmes' unsupported enthusiasm and actual motive underlying the acquisition of the marketing rights to the CD-3000 is abundantly clear.

Finally, Holmes recklessly, if not falsely, projects sales and earnings of an unprecedented and unsupportable amount attributable, in part, to the CD-3000. Porter's original draft of the "fact file" (*Id.*, pp. 407-0558-0562) says nothing about Aero Systems' earnings. In Holmes' redraft for PLR's use in the fact file (Id., pp. 407-0563-0566 at p. 406-0563), Holmes wrote:

> Aero Systems Inc., is the most exciting situation that (Porter LeVay & Rose) have ever had to work with. (PLR) believe(s) the Company is on the verge of a major breakout in both sales and earnings, that could exceed $50 million in sales and $1.50 to $2.00 in earnings by 1983 as a result of:
>
> • • •
>
> c. Sale and lease revenues from the Company's unique new Fuel Saving Computer which potentially could dwarf the Company's entire operations.

Holmes' predictions appeared in the final "fact file" (Exh. 970, p. 407 0153).[84] The final version of the "fact file", together with Holmes' letter to shareholders was sent by mail to approximately 5,000 members of the financial community (Porter pp. 81-82; Exh. 970).

PLR's report had the desired effect. As Porter reported to Holmes on September 22, 1980 concerning PLR's August 1980 efforts: "The report was widely distributed

[84]Aero Systems' *actual* sales and earnings were:

	1981	1982	1983
Sales	$14,487,016	$17,163,786	$26,918,626
Earnings	.06	.10	.21

Aero System 1983 Annual Report (Exh. 5261)

. . . We have received numerous responses from the report and have seen an increase in the stocks' activity . . . *Roger Garrity* of Investors Financial Services, Inc. and *Joe Lugo* of First State Securities *both told us that the interest in the stock is being generated from the report"* (Exh. 978) (emphasis added).[85]

Also, in July 1980, Holmes was interviewed by Martin Merzer of the Miami Herald and told Merzer the falsehood that "Our tests show (the CD-3000) can result in fuel savings of up to 10%" (Exh. 119; Merzer pp. 8-9). Aero Systems had received no written test results (RFA 945).[86]

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In March 1981, in the ABD, Aero Systems placed an ad claiming "up to 10% fuel conservation" (Exh. 5234). Smart Money published an article in its April 1981 issue stating that "[w]ith the CD-3000 a pilot can save from 4% to 16% (of fuel) . . ." (Exh. 137). Also, in an article appearing in the OTC Review in July 1981, it's again reported that the CD-3000 ". . . is designed to reduce an airplane's fuel consumption by as much as 16 percent . . . "(Exh. 5244A). On June 17, 1981 Holmes released over PR Newswire that "The CD-3000 . . . *can* save up to 10% of the fuel consumption . . . "(Holmes, pp. 500-501; Exh. 5242) (emphasis added).

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[85]During this time period, PLR, *inter alia*, prepared and distributed to the financial community at least four releases on the CD-3000 (Exh. 953, p. 407-0096; Exh. 959, p. 407-0080; Exh. 971, p. 407-0028).

[86]Aero Systems claims to have conducted tests, but the tests didn't provide any percentage of fuel savings because Aero Systems wasn't "actually using any fuel" (Holmes pp. 185-186).

e. Holmes Released False and Misleading Information Regarding Airlift International

On January 27, 1981 Holmes issued a press release stating that Aero Systems had signed an agreement with Airlift International, Inc. ("Airlift"), describing Airlift as the "first commercial airline user" of the CD-3000 (Exh. 5226). Holmes claims that "Airlift will also provide Aero with documented fuel savings operating results" (*Id.*). This announcement appeared in Barron's on February 2, 1981 (Exh. 5227), the February 9, 1981 Aviation Week publication (Exh. 5232), and Fortune Magazine on March 9, 1981 (Exh. 5235).

Holmes failed to disclose that all Airlift flew as a "commercial" airline were freighters (Sovacool, p. 57) and that the CD-3000 was going to be "tested" on Airlift's long distance airplane (Sovacool, pp. 57-58). He did not disclose that such "tests" on a single aircraft vary not only with respect to the types of aircraft involved but aircraft within the type itself (Sovacool, pp. 123-124). He failed to disclose that loss of time caused by use of the CD-3000, a serious concern of passenger airlines, was of no concern to Airlift (Sovacool, p. 164). He failed to disclose that slowing cruise time[100] of an airline aircraft increases crew and maintenance costs, and that as incremental costs approach the marginal cost of fuel, the value of the CD-3000 diminishes (none of which was considered by Airlift or in its report) (Sovacool, pp. 130-131). Finally, he failed to disclose that the pilot can obtain the same results by using a flight plan as from using the CD-

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[100]Cruise time is the time that you enter into a steady state operation from the top of the climb until the top of the descent (Sovacool, pp. 128-129).

3000; the CD-3000 only makes the information more convenient (Sovacool, pp. 82-83).

Holmes then sent a letter to shareholders on March 16, 1981 telling them that Aero Systems is "currently installing [the] CD-3000 . . . on our first large commercial jetliner" (Holmes, p. 383; Exh. 1011). He makes the same omissions, and additionally, chooses not to name Airlift International. He finally acknowledges that "pilot acceptance is the key" to the success of the device (*Id.*), one of the cautions told to him by Hayden a year before.[101] Holmes continues to emphasize that the company is "on the verge" of success; *i.e.*, " . . . [t]he documented results are expected to be the trigger to volume sales and leases to the world's major airlines. We are now more confident than ever about the success of our CD-3000 . . . and feel we are on the verge of a major breakthrough" (*Id.*).

On May 7, 1981 Holmes issued another press release (Exh. 1038).[102] Holmes reveals that "preliminary indications" of the testing by Airlift "appear to be quite significant" (*Id*). He "quotes" Sovacool to the effect that he, Sovacool, has recommended that Airlift "outfit the entire

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[101]The prospect of "real" test data from Airlift International also coincided with Holmes' discharge of PLR on April 20, 1980 (Exh. 1009). It's submitted that Holmes didn't need PLR's further assistance or costs in disseminating Holmes' phoney statistics.

[102]On May 1, 1981 — six days before this first public release which in any way relates to any actual testing, or whether or not the tests were "encouraging," Moore Schley distributed a report to its brokers stating that Airlift test results are "quite encouraging" and that "[f]inal [test] results should be available shortly" (Exh. 139). That was not public knowledge on May 1. Regardless of whether or not the statements were true, it appears that Holmes passed on inside information which was used by Moore Schley.

fleet" with CD 3000's.[103] The letter further states that the tests have not been completed, and Holmes says the tests are scheduled to "continue for another week . . . " after which the data must be "consolidated and compared with prior fuel consumption . . . in order to document . . . fuel savings." The alleged test data on which the final report was based was already completed by this date; the final report shows the "testing" took place between March 15 and April 15, 1981 (Sovacool, p. 120; Exh. 1039). Thus, Holmes misrepresented the extensiveness of the testing, and that it was to continue.[104]

In another letter to shareholders on May 18, 1981, Holmes repeats Sovacool's "quote" and states that Sovacool says the device "does more than [was] anticipated" (Holmes, p. 486; Exh. 145). In fact, Sovacool testified that he had no way to anticipate any particular percentage of fuel savings (Sovacool, p. 32).

The Airlift International report was released on July 14, 1981 and was signed by Robert Sovacool, Airlift's Director of Flight Operations (Exh. 1039). Holmes drafted both Sovacool's forwarding letter and the report.

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[103]The fact that the "entire fleet" consisted of a total of nine planes (Sovacool, p. 58) was not disclosed. Also, the "quote" by Sovacool was written by Holmes, not Sovacool. (Holmes, p. 1907).

[104]Neither Aero Systems nor Holmes have produced any "test" results, raw data, calculations, compilations, analyses or other documents to back up the Airlift "tests". Sovacool says they were given to Aero Systems (Sovacool, pp. 83-84; 87; 104-105). The documents Sovacool says were given to Aero Systems were not produced by Aero Systems in this litigation despite repeated efforts to get them (Taylor Decl. ¶ 6). The fact that documents of such obvious importance to Holmes were not produced raises serious questions not only as to the validity of any interpretation of their results, but of their very existence.

and Sovacool signed them (Holmes, pp. 1911-1912; 1914). Holmes can't point out any changes made by Sovacool (Holmes, p. 1915). Holmes had first received the report in June (Holmes, p. 1911). This report, which Holmes calls the "Airlift test package" (Holmes, p. 1913) was the report which Holmes sent to other airlines (Holmes, pp. 1912-1913).

On July 24, 1981 Holmes sent *another* letter to shareholders extolling the Airlift test results (Holmes, p. 517; Exh. 149). He states that "even though Airlift temporarily ceased operations prior to collecting sufficient data ... their best estimate is that the final results ... could reflect fuel savings in excess of 10% ..." Holmes does not tell his shareholders that Airlift went bankrupt in June, 1981 (Sovacool, p. 8), that after bankruptcy was filed, the aircraft (with the CD-3000 on it) was repossessed and when Airlift got it back, the CD-3000 was gone (Sovacool, p. 39). Holmes says that the tests are "expected to generate immediate sales" to operators of DC-8-63's (Airlift's type of craft).[105]

Further, the Airlift report itself, approved by Savacool but written by Aero Systems (Sovacool, p. 115; Exh. 1039),[106] Holmes admits writing most of the report (Holmes, p. 1906).

The report clearly states that 2% of the alleged fuel savings is speculative because tests "were interrupted"

[105]Note that several DC-8-63 operators were unable to use the CD-3000 to achieve maximum specific range, because instability resulted, forcing the pilot to burn additional fuel to regain stable cruise conditions. (*See, e.g.,* Exh. 3884). Further, by December, 1987, only one CD-3000 was sold to be installed in a DC-8-63 (Exh. 5284).

[106]Holmes admits that the Airlift report itself was *not* sent to shareholders (Holmes, p. 1966).

before comparative calculations could be made (Exh. 1039, p. 001 01592) and that the total resulting savings would be "*between* 4% and 6%" (*Id.*) (emphasis added), not that they would be "in excess of 6%" as he later tells his shareholders.[107]

Against this storm of hyperbole and unsupported representations by Holmes of the "fuel percentage savings" to his shareholders and the stock buying public, one must measure what Aero Systems *really* believed the CD-3000 could do.

On July 1, 1981 George Nelson, the recently hired Vice-President, Fuel Computer Marketing, who had the primary responsibility for the world-wide marketing of the CD-3000 (Exh. 5242), sent letters to Japan Air Lines, Gulf Air, Dan Air Service, Cathay Pacific Airways, All Nippon Airways, Air France, Muse Air, Deutsche Lufthansa, Sudan Airways, Transavia Holland and UTA guaranteeing *only* 2% fuel savings by use of the device (Exhs. 3848). Thus, what Holmes was telling the stock-buying public and what Aero Systems was telling those who were sophisticated in the business were two entirely different things.

* * *

C. HOLMES PARTICIPATED IN AND ASSISTED IN THE BUNNINGTON STOCK MANIPULATION

Holmes was a direct participant of the Bunnington stock manipulation, and aided and abetted that manipula-

[107]Holmes' obsession with "percentage of fuel savings" is not to be underestimated. According to this own representations of the size of the market — 30 billion dollars — a one percent reduction in fuel costs, equals 300 million dollars! Thus, a misrepresentation of only 1% to his shareholders and the public is not a *de minimus* representation.

tion.[108] It was done by Holmes through Lugo and Moore Schley, both of which had so greatly benefited Holmes and Aero Systems.

1. Holmes Invested Heavily in Bunnington Through Private Transactions

Aside from the transactions between Holmes and Bunnington set forth above, and his relationships with the Bunnington principals, Holmes was familiar with Bunnington and was a substantial shareholder of Bunnington.[109] Holmes received Bunnington Annual Reports and shareholder letters (Holmes, p. 996).

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2. Holmes Actively Traded Bunnington

In addition to Holmes' purchase of Bunnington stock and the debenture through private transactions, Holmes traded heavily in Bunnington stock to assist Lugo and Bunnington in the manipulation of Bunnington stock.

During the period of time from September 3, 1977 through May 20, 1981, Holmes purchased 61,900 shares of Bunnington on the open market. The aggregate cost of the

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[108]It is the opinion of John Torkelsen, one of plaintiffs' experts, that the stock of Bunnington was manipulated (Torkelsen Decl. ¶ 22).

[109]Holmes also was familiar with Aerosonic. In January, 1980 Ronald Rotstein of Capitalgains spoke with Holmes (Exh. 2631). Rotstein asked Holmes about Aerosonic (Rotstein pp. 46-47). Holmes told Rotstein that Holmes "[k]nows Aerosonics — recording altimeters used in conjunction with collision avoidance systems (CAS) *have the capability to drastically reduce air crashes*" (emphasis added), but told Rotstein "no direct quote here" (Rotstein, pp. 46-47). It is this "CAS" device — again a gimmick that could *not* "drastically reduce air crashes" as Holmes misrepresents — that Aerosonic was hyping to push its stock price up.

purchase was $364,875.00 at an average cost of $5.79 per share. A total of 60,900 of the shares purchased were subsequently sold for total proceeds of $357,203.57, at an average price of $5.87 per share (Foley Decl. ¶ 90).

Holmes purchased 45,900 of the Bunnington shares through FSSC in twelve transactions (Foley Decl. ¶ 87). Holmes received preferential treatment from FSSC in connection with his purchases, at prices lower than the lowest NASDAQ reported asking price. This preferential pricing amounted to a total of $13,237.50 to Holmes' benefit (Foley Decl. ¶ 94). With the exception of one transaction, these securities were sold through broker-dealers other than FSSC in sixty-six separate transactions (Foley Decl. ¶ 95). This created the appearance of market activity, which had the natural result of artificially maintaining or raising the market price of the stock (*See* Foley Decl. ¶, 102).

Holmes' purchases assisted Lugo in creating market demand for the securities and controlling the public float of Bunnington stock (Foley Decl. ¶ 99). Nine out of twelve of Holmes' purchases between May 31, 1979 and May 20, 1981 represented more than 51% of NASDAQ's average daily volume (Foley Decl. ¶ 98). Further, between March 1, 1981 and July 24, 1981, Holmes was the largest single buyer of Bunnington stock, for 10,000 shares (Foley Decl. ¶ 99). This occurred at a time when there was little or no market demand for the stock (Foley Decl. ¶ 102).[112] During the same period, the largest seller of Bunnington stock was Vigman, selling 17,000 shares under Rule 144. (Foley Decl. ¶ 100)

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[112]During the March 1 through July 24, 1981 period, a total of 145,000 shares of Bunnington were sold by FSSC customers. Only 45,000 shares were purchased (Foley Decl. ¶ 100).

Holmes' profit from these transactions amounted to only $368.48. It is a triable issue of fact whether or not purchases at FSSC and subsequent sales were made for the purpose of assisting Lugo with the domination and control of the float of Bunnington common stock. (Foley Decl. ¶ 98, 99, 124)

* * *

N. HOLMES PARKED BUNNINGTON STOCK WITH LUGO

On May 18, 1981, FSSC's inventory reached an all time high of $688,378. Included in FSSC's inventory were 19,208 shares of Bunnington common stock with a market value of $235,298. At this level of inventory, FSSC's Net Capital was deficient by $136,222 (Foley Decl. ¶ 46).

In May of 1981, all trades through May 21st were included in FSSC's net capital computation for its monthly Net Capital Report to the NASD (Foley Decl. ¶ 52).[118]

In order to create the appearance of compliance with the Uniform Capital Requirements under SEC Rule 15C-3-1, Lugo "parked" securities with customers to conceal the true state of its inventory positions from the NASD (Foley Decl. ¶ 47).

Holmes' account at FSSC was one of the customer accounts used for parking securities that were properly attributable to FSSC's inventory. On May 20, 1981, an

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[118]FSSC reported its Net Capital to the NASD on a monthly basis, using the last Friday settlement as the closing date for financial statement and net capital computation. Trades as of May 21st were settled on May 29th, allowing five business days and one extra day to allow for the Memorial Day holiday, pursuant to the NASD Uniform Practice Code Paragraph 3504, Section 4 (Foley Decl. ¶ 52).

order to purchase 5,000 shares of Bunnington stock was entered in Holmes' account. The transaction reflected a purchase price of $61,250.00, with payment to be made by delivery to Holmes' bank, First Southeast National Bank of Miami Springs, Florida (Foley Decl. ¶¶ 49, 55).

The transaction reduced the value of the Bunnington inventory by $61,250, thereby reducing the amount of capital required by the SEC. However, this was not a *bona fide* transaction (Foley Decl. ¶ 51).

On May 29, 1981, an order to sell 5,000 shares of Bunnington was entered in Holmes cash account at FSSC, for a sale price of $61,875 to be settled on June 5, 1981 (Foley Decl. ¶¶ 49, 53).

On June 1, 1981, four days before settlement of the May 29 sale of the 5,000 Bunnington shares, FSSC made a prepayment of $61,875 to Holmes. This occurred prior to Holmes' payment for the purchase of the securities on May 20, 1981 (Foley Decl. ¶¶ 53, 54).

To make the prepayment on June 1, 1981, FSSC had to borrow funds from SCCP. An employee of FSSC, Robert Reber, delivered the check which Holmes endorsed over to his bank. On the same day, Holmes' bank wired $61,250 to SCCP to be credited to the FSSC loan account for payment of the stock originally purchased on May 20, 1981. Ordinarily, payment would be made by a draft sent to FSSC's own bank to be credited to FSSC's bank account (Foley Decl. ¶¶ 53, 54).

Through these transactions, Holmes "paid" for the 5,000 Bunnington shares with the FSSC's funds. This is known as a "free ride", and is expressly forbidden by a SEC Rule. Further, FSSC's inventory of Bunnington stock was increased by 5,000 at a value of $61,875 (Foley Decl. ¶¶ 61, 62)

The shares sold on May 29, 1981 (settling on June 5, 1981) appear to be the same ones purchased on May 20, 1981, although Holmes claims that they are not (Holmes, p. 2842). Holmes claims that the shares sold on May 29, 1981 were purchased on May 5, 1981 through Lugo in Holmes' DVP account at FSSC, and claims that they were delivered to cover the May 29, 1981 sale (*Id.*).

However, it does not matter which certificates Holmes delivered to cover the May 1, 1981 sale, since even if the certificates for the May 5 purchase were delivered, it still does not change the effect that the May 20, 1981 purchase had to mask FSSC's net capital deficiency. The transaction was a park, particularly because the sale takes place soon after the May net capital reporting period, and because the proceeds from the May 29, 1981 sale (paid in advance) were used to pay for the May 21 purchase (Foley Decl. ¶ 58).

The following chronology of the sale and prepayment on June 1, 1981 shows the coordination between Lugo and Holmes to execute the "parking" transaction, while maintaining the appearance of legitimacy:

a. Holmes endorsed the check;

b. Reber hand delivered the check to Holmes' bank on June 1 for deposit;

c. The bank stamped the check and sent it through the clearing house on June 1;

d. The bank wired to SCCP the $61,250 needed to pay for the DVP purchase on June 1 to credit the FSSC loan account;

e. FSSC borrowed $125,000 on June 1 to cover the check to Holmes;

f. Holmes paid for the stock purchase after he received the prepayment, in effect, using FSSC's own funds to pay for the purchase;

g. Holmes sold 53,900 shares on 64 different trades between March 2, 1979 and June 16, 1981. The 5,000 bunnington share sale on May 29, 1981 was Holmes' only sale through FSSC during the March 2, 1979 to June 16, 1981 period (Foley Decl. ¶ 63).

B. THE EFFECT OF THE MANIPULATIVE SCHEME ON THE CAPITAL OF FSSC AND SEBAG

1. FSSC — March 1981 to July 1981

At the end of March 1981, FSSC had a capital deficiency. Although there was total capital in the amount of $209,917 — an excess of $67,841 — there was a deficiency of $120,273 in the Customer Reserve Account. Since there was only $16,000 in the FSSC checking account, Lugo should have either sold inventory to raise cash to meet the requirement or obtained a major infusion of capital from FSSC's principals. Lugo did neither (Foley Decl. ¶¶ 32, 33).

Between March 27, 1981 and April 24, 1981, FSSC's inventory value more than doubled, from $182,000 to $415,000. During this time, FSSC's capital declined 40% for a net capital deficiency of $16,625, and FSSC's Customer Reserve Account deficiency grew to $199,793. (Foley Decl. ¶ 34).

During this time period, Vigman made available to Lugo proceeds generated from the sales of Nettie Vigman's inflated Aero Systems stock to finance FSSC's continued operation, and to increase FSSC's inventory of the target securities. The credit balance in Nettie Vigman's account effectively provided Lugo with an inter-

est free loan of more than $230,000 in April 1981 (Foley Decl. ¶¶ 27, 34).

By the end of April 1981 Lugo was aware of FSSC's capital deficiency problem. He then ceased withdrawing his monthly compensation from the firm. Lugo used his salary and trading profits to relieve FSSC's deteriorating financial condition. At the close of the April reporting period for net capital, Lugo had to pay Nettie Vigman her credit balance. In order to do this, Lugo borrowed $100,000 from SCCP, and to conceal FSSC's financial condition, the loan was not recorded in FSSC's Customer Loan Account (Foley Decl. ¶¶ 27, 39, 40, 41, 42).

By May 29, 1981, FSSC had a net capital deficiency of $102,165. FSSC's inventory, adjusted to correct for securities parked by Holmes and others totaling ($213,125) was $619,000. The deficiency in FSSC's Customer Reserve Account was now $420,917. Again, to pay Nettie Vigman, Lugo borrowed $300,000 from SCCP, which was not reported in FSSC's Customer Loan Account (Foley Decl. ¶¶ 35, 39).

As a result of the "parks" in the accounts of Holmes and others, Lugo was able to create the appearance of capital compliance and FSSC's financial deterioration was shielded from the NASD. (Foley Decl. ¶ 36-38, 43)

Had FSSC ceased doing business in May 1981, FSSC's calculated losses would have been $779,594. However, by FSSC continuing in business through July 24, 1981, FSSC's losses increased to $2,634,976 (Foley Decl. ¶¶ 83, 84).

Without Holmes' participation in the May 1981 parking transaction, FSSC could not have created the appearance of net capital compliance. The concealment of FSSC's true financial condition allowed Lugo to continue in

business, and as a result, the financial condition of FSSC worsened. FSSC's continued operation after May 29, 1981, permitted the following to take place:

a. FSSC continued to build up its inventory in Bunnington and Aerosonic stock;

b. FSSC's Customer Loan Account increased by $1,000,000 at SCCP;

c. FSSC's net capital deficiency and related losses increased by more than $1.8 million; and

d. FSSC's trading losses and reserve deficiency increased from $779,594 (as of May 29, 1981) to $2,634,976 (as of July 24, 1981) (Foley Decl. ¶¶ 81, 86).

2. SEBAG, — May 29 to July 27, 1981

On May 29, 1981, Sebag had total capital of $1,900,000. There was only $110,000 of Aerosonic, Bunnington, Dash and Osrow stock in inventory. (Foley Decl. ¶ 64). However, during June and July 1981, Garrity purchased more than $7,000,000 worth of these stocks from FSSC and other market makers to stabilize the market price of the securities. Of this amount, 95% of the securities purchased were in Bunnington, Aerosonic and Osrow. These securities were sold to the accounts of Garrity, his family members, Velma Shaw, and other customers. However, 46% of these purchases were ultimately never paid for and were purchased into Sebag's inventory pursuant to Regulation T at a cost of $3,300,000 (Foley Decl. ¶¶ 65, 66, 67).

Of the purchases paid for, a substantial number were financed through margin accounts. These margin purchases increased Sebag's bank loans, for which Aerosonic, Bunnington and Aero Systems stock were pledged

as collateral. Losses resulting from a decline in the value of pledged securities exceeded $5,000,000 when the price of Aerosonic dropped from $11.00 to $5.00 and Bunnington dropped from $12.00 to $2.50 by July 27, 1981 (Foley Decl. ¶ 70, 74).

Had FSSC ceased operations at the end of May 1981 instead of July 24, 1981, the damages to both FSSC and Sebag would have been substantially less (Foley decl. ¶ 83)

3. SIPC's liquidation of FSSC and Sebag

Pursuant to SIPA, liquidation proceedings were initiated against FSSC and Sebag on July 24 and July 27, 1981, respectively. Under the provisions of SIPA, SIPC paid a total of $12,453,475.26 to the Trustee of FSSC and Sebag.

The acts of Holmes as set forth above led to and were a substantial contributing factor to the losses and damages incurred by SIPC and the two trustees.

III.

CONCLUSION

Holmes' activities as described in this memorandum are intentional and criminal, and were committed by Holmes not only for his own enrichment but to aid and abet the enrichment of Vigman, Diamond, Lugo, Garrity, Blumenthal and others.

Each historical relationship, each act and each profiting illustrates that Holmes' conduct must, at the very least, be weighed by a jury. Holmes did not act alone, and he didn't profit alone, as counsel for Holmes would have this Court believe. Holmes and the others, acting in concert since as early as 1966 must now sit in concert before a

jury so that their acts can be judged. Holmes motion must be denied.

Dated: September 20, 1988

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No. 90-727

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
Petitioner,

VS.

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, Trustee for the Liquidation of Joseph Sebag Incorporated, and LAURENCE A. SCHROEDER, Successor Trustee for the Liquidation of First State Securities Corporation,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S BRIEF IN REPLY TO OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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PETITIONER'S BRIEF IN REPLY TO OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

INTRODUCTION

Petitioner Robert G. Holmes, Jr. ("Holmes" or "Petitioner") hereby respectfully submits the following reply to the Respondents' brief in opposition to his petition for a writ of certiorari to the United States Court of Appeal for the Ninth Circuit.

ARGUMENT

A. The Court Should Grant A Writ of Certiorari To Review The Application Of The Purchaser/Seller Rule In RICO Suits Where The Alleged Predicate Acts Are Violations Of Rule 10b-5 Because The Decisions of The Circuits Which Have Addressed The Issue Are In Conflict, Are Not Reconcilable, And The Conflicting Opinions Are Already Sufficiently Illumined

In opposition to the petition for a writ of certiorari, Respondents suggest that the conflict which exists among the decisions of the Ninth and Eleventh Circuits, on the one hand, and the Fourth and Eighth Circuits, on the other hand, with respect to the application of the purchaser/seller rule in RICO suits, is not yet "ripe" for review. Essentially, Respondents urge the Court not to review the Ninth Circuit's decision below, even though there is an admitted conflict among the circuits, because there are other circuits which have not yet addressed the application of the purchaser/seller rule in the RICO context.

The non-existence of other circuits' decisions, however, should not preclude the Court's review of this issue at this time. The conflict which exists among the four circuits which have addressed the purchaser/seller issue in the context of RICO is concrete. While Respondents argue that the conflict should "become irreconcilable" before review, they do not suggest that the decisions of the Ninth and Eleventh Circuits are reconcilable with those of the Fourth and Eighth Circuits.

Respondents hint that review is also not appropriate at this time because the issue of the purchaser/seller rule's application in RICO actions needs further study. (Opposition Brief at 10.) Respondents do not say in what respects further study is required. In fact, the raison d'etre of the purchaser/seller rule of standing in securities fraud actions brought under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act") is well established and has been articulated over forty years of federal securities law jurisprudence.[1] Under the purchaser/seller rule, only the actual purchasers or sellers of securities can sue for fraud damages. If the Ninth and Eleventh Circuits' position that the purchaser/seller rule does not apply in RICO actions predicated on Section 10(b) and Rule 10b-5 violations ultimately prevails, the purchaser/seller rule would cease to be an effective limit on the right of certain plaintiffs to sue for damages on claims essentially based on Section 10(b) and Rule 10b-5 violations.

The reasons which spawned the purchaser/seller rule, however, remain intact. The purchaser/seller rule originated to limit the plaintiff class in Section 10(b) and Rule 10b-5 private damages actions to actual purchasers or sellers of securities because Congress did not provide an express private right of action for alleged violations of Section 10(b) and Rule 10b-5. Instead, the courts developed an implied right of action.[2] The reason for limiting the plaintiff class to actual purchasers and sellers of securities is that Section 10(b) and Rule 10b-5 "proscribed only fraud in connection with the purchase or sale of securities, and ... the history of [Section] 10(b) revealed no congressional intention to extend a private civil

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[1] *See International Data Corp. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987) (RICO was enacted against a backdrop of forty years of federal securities laws).

[2] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975).

remedy for money damages to other than defrauded purchasers or sellers of securities. . . ."[3]

This Court has noted the policy considerations which support the purchaser-seller rule and has stated that the rule provides "countervailing advantages" to any disadvantages which arise from the rule's limitation on private suits.[4] Among these policy considerations are the vexatiousness of securities fraud litigation, the possibility of large judgments whose incidence would devolve on investors (and the public at large), the possibility of coercive settlements, the possibility of "strike" suits, the extensiveness of discovery in securities fraud actions, the difficulty of disposition of suit by summary proceedings and, ultimately, the disruption of normal business activity.[5]

Section 10(b) and Rule 10b-5, of course, have never been amended to provide for an express private remedy or to revoke the judicially developed limitations on suit. The question for this Court's consideration, therefore, which is raised in the instant petition for a writ of certiorari, is whether the fact that RICO provides an express remedy for its violation entitles a plaintiff, who *expressly* alleges violations of Section 10(b) and Rule 10b-5 as the "predicate acts" which caused his injury, to sue and recover treble damages under RICO, when the same plaintiff would have been barred if he or she had sought recovery under the Exchange Act. Petitioner's position is that if a plaintiff is allowed such recovery under RICO, then RICO would effectively eclipse the Section 10(b) and Rule 10b-5 bar and would, in effect, grant a right of action, by way of

[3]*Id.* at 731.

[4]*Id.* at 738-39.

[5]*Id.* at 739-743.

RICO, to otherwise barred plaintiffs to sue for Section 10(b) and Rule 10b-5 violations.[6]

To bolster their argument that there is not yet a deliberate conflict among the circuits, Respondents nebulously add that the positions of the Eleventh and Eighth Circuits "are at best cryptic." (Opposition Brief at 10.) Cryptic or not, the positions of the Eleventh and Eighth Circuits have precedential value and may be followed by other courts.[7] In fact, in the courts below, Respondents expressly relied upon the very Eleventh Circuit's decision which they now cast askance as "cryptic."

Too, the Ninth Circuit, in its decision below, cited the Eleventh Circuit's decision in analyzing the purchaser/seller rule under the provisions of RICO.[8] Therefore, contrary to Respondents' suggestion that "the basic arguments have [not] been fully made," the basic arguments have crystallized sufficiently for different courts to adopt different positions on the same legal issue, and for litigants, such as Petitioner and Respondents here, to cite

[6]The question presented deals exclusively with recovery under RICO for damages based upon alleged violations of Section 10(b) and Rule 10b-5 under the Exchange Act and not other provisions of the federal securities laws. The Court has stated in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985), that the compensable injury under RICO is the harm from the *predicate acts* sufficiently constituted to form a "pattern" of racketeering. *Sedima*, 473 U.S. at 497. Thus, when the predicate acts are violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the plaintiff in effect seeks compensation under RICO for the defendant's violations of Section 10(b) and Rule 10b-5.

[7]*See* 20 Am. Jur. 2d *Courts* § 186 at 521 (1965) (courts do not lightly overrule a precedent) and 20 Am. Jur. 2d *Courts* § 190 at 526-27 (1965) ("courts have sometimes given dicta the same effect as holdings . . .").

[8]*SIPC v. Holmes*, 908 F.2d 1461, 1466 (9th Cir. 1990).

those conflicting positions in support of their respective cases. Respondents' argument that more circuits should rule on the issue before the issue is "ripe" for adjudication is unavailing because, taken to its logical conclusion, no issue would ever ripen as long as there are some circuits which have not yet spoken.

Respondents also disagree with Petitioner's suggestion that the Ninth Circuit's decision will tend to increase civil RICO litigation against legitimate businesses and that this might result in judgments against these businesses that will be punitive beyond the actual culpability of the businesses. Respondents cite to one of their counsel's statistical data collected in a law review article as evidence that Holmes' prediction of increased RICO litigation will not come to fruition. The data cited do not purport to address the increase in suits by plaintiffs who previously did not sue because of the real or imagined bar of the purchaser/seller rule. Moreover, regardless of the merits of the data, the removal of an impediment to standing would logically free an unknown number of potential plaintiffs to sue under RICO on suits barred by the purchaser/seller rule under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Moreover, it is precisely because RICO applies to both legitimate and illegitimate enterprises that it becomes imperative for this Court to review the Ninth Circuit's decision. Securities transactions affect a great majority of legitimate business enterprises. If in fact legitimate business enterprises find themselves deluged by a wave of fraud litigation by a new class of plaintiffs, the cost of response to such litigation, including judgments paid, will ultimately be borne by the society at large. By alleging that violative securities transactions occurred as a pattern of "predicate acts," plaintiffs could convert otherwise garden variety fraud claims into federal RICO claims for which treble damages might be recoverable at a societal cost out of step with any deterrent value to the alleged fraud.

It might be appealing to rejoin the foregoing arguments with the suggestion that non-purchasers or non-sellers of securities who are able to prove injury from securities fraud should be compensated under RICO, without impediment of standing limitations. RICO, however, is not merely compensatory, it is punitive. When RICO's punitive effect is directed toward legitimate business enterprises by plaintiffs who previously might not even have had a securities fraud claim against such business enterprises, the result will be to foster the very dangers against which *Blue Chip Stamps* sought to guard.

B. The Opposition Mis-States The Question Presented By Petitioner Holmes With Respect To Conspiracy Liability And Does Not Oppose Or Address The Question Actually Presented

Respondents' Opposition describes the question presented in the Petition in connection with the issues of causation and conspiracy as follows:

> "Petitioner contends that the circuit court's decision holding that a consiprator is liable for his co-conspirators' conduct ought to be reviewed by this Court." (Opposition Brief, page 17.)

In fact, this contention attributed to Petitioner entirely mis-states the question raised by Petitioner. The question actually presented for review relates to a condition precedent to a determination of a person's status as a conspirator, not the admitted and undisputed consequences which follow after a person is determined to be a conspirator. The question presented by Petitioner relates to whether it

is required that a determination of some causal connection be found between the conduct of an alleged conspirator and the harm complained of before the alleged conspirator may actually be deemed to be a co-conspirator. It is undisputed that after an alleged conspirator is determined to be a conspirator, no further causal inquiry is made in order for the conspirator to be liable for the conduct of his co-conspirators.

Petitioners' Opening Brief describes the issue presented as follows:

> "If the alleged conspirator's conduct was not causally related to the injury, then it is compelling that the alleged conspirator was not in fact a conspirator. To hold otherwise, as did the Ninth Circuit, widens the scope of liability to a defendant beyond reason. . . . Such a causal connection should be required as a condition to determining that a particular individual is a co-conspirator, particularly since the law is well settled that once co-conspirator status is established, no further causal connection between the conduct of the co-conspirator and the ultimate loss need be established." (Petitioner's Opening Brief, page 19.)

Because Respondents refuse to recognize the question actually raised by Petitioner, Respondents "arguments" are entirely misplaced. Respondents' first argument is entitled as follows: "There Is No Split In The Circuits On The Issue Of Whether Conspirators Are Liable For The Acts Of The Co-Conspirators" (Opposition Brief, pages 17-18). This argument is beside the point, as Petitioner does not dispute that conspirators are liable for acts of co-conspirators without further inquiry into causation.

Similarly, Respondents' second argument entitled "Petitioner's Attempt To Distance Himself From His Co-Conspirators Does Not Warrant The Court's Review" (Opposition Brief, pp. 18-22) amounts to a quibble over the state of the record below and an attempt by Respondents to reargue the basis for the grant of summary judgment and does not focus on the question presented for review. In effect, Respondents have chosen to argue about, and to attribute to Petitioner, questions other than those presented in this Petition.

CONCLUSION

For the reasons stated in Petitioner's Opening Brief, this Court should issue a Writ of Certiorari to review the Judgment of the Court of Appeals for the Ninth Circuit.

Dated: January 8, 1991

Respectfully submitted,

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(4)

No. 90-727

Supreme Court, U.S.
FILED
JUN 6 1991
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1990

ROBERT G. HOLMES, JR.

Petitioner,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

JOINT APPENDIX
VOLUME I

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DATE	NR	NO.	PROCEEDINGS
09/27/84	am	248.	First Amended Complaint; demand for Jury Trial. Issued Summons. Pltfs.
11/26/84	as	275.	Notice of motion by Defendant Robert Holmes, Jr. to dismiss the complaint; memo of Points and Authorities. 3/4/85 at 10:00 a.m. Deft. Holmes, Jr.
11/26/84	as	278.	Defts. consolidated memo in support of motion to dismiss based on lack of SIPC standing, 3/4/85, 10:00 a.m. Deft. Creditbank.
11/26/84	as	279.	Notice of consolidated motion of Defts. to dismiss first Amended Complaint based on lack of SIPC standing, 3/4/85 at 10:00 a.m. Deft. Creditbank.
11/26/84	sb	284.	Notice of consolidated motion of Defts. to dismiss first Amended Complaint based on lack of Trustees standing, 3/4/85, 10:00 a.m. Deft.
01/10/85	as	313.	Pltfs memo of Points and Authorities #2 in opposition to motion to dismiss Trustee claims for lack of standing and Holmes motion to strike Pltfs prayer for punitive damages, 3/4/85, 10:00 a.m. Pltf.

01/10/85	as	315. Pltfs memo of Points and Authorities #3 in opposition to defts consolidated motion to dismiss claims of Securities Investor Protection Corp for lack of standing, 3/4/85, 10:00 a.m. Pltf.
01/17/85	as	320. Exhibit A to pltfs memo of Points and Authorities #2, in opposition to Dfts consolidated motion to dismiss trustee claims for lack of standing, Holmes motion to strike pltf prayer for punitive damages, 3/4/85, 10 am pltf
02/11/85	as	326. Defts Consolidated reply memo in support of motion to dismiss based on lack of SIPC standing 3/4/85, 10:00 a.m. Deft. Creditbank.
02/11/85	as	328. Reply by deft Robert G. Holmes Jr. to pltfs memorandum of Points and Authorities #2 in opposition of deft motion to dismiss and Holmes motion to strike pltfs prayer for damage, 3/4/85, 10 am Deft
02/11/85	as	330. Defts. consolidated reply memo in support of motion to dismiss Trustee Claims, 3/4/85, 10:00 a.m. Deft.

03/04/85	sb	338. Court order motion to dismiss lack of Trustees standing and lack of SIPC standing denied and court grants SIPC 10B claim and denies SIPC motion: to dismiss denied without prejudice mont to dismiss RICO Deft. lack of personal jurisdiction denied and court order motion denied motion withdraw reference to Bankruptcy granted as to adversary proceeding status conference 9/9/85 at 3:00 p.m. mo
03/14/85	kw	342. ORD (1) references to Bankruptcy Court of adversary proceeding entitled Securities Investor Corp. vs Garrity (in Garrity, BK #SA85-00083-PE, Adv. #SA85-0138-PE ("Garrity Action") is withdrawn and all proceedings in that action be taken before this court.; (2) Garrity Action is consolidated with SIPC Action for all purposes; (3) case #CV-83-5674-AWT (Tx) Cain vs Vigman is consolidated with SIPC Action for purposes of discovery; (4) pltfs claims against Frankie Mae Garrity and Rodger W. Garrity in SIPC Action only are severed from all other claims in the consolidated actions for all purposes; (5) this Order be filed in SIPC Action, Garrity Action, and Cain Action; (6) pending further Order of Court, all pleadings and papers shall be filed in #CV-83-4742-AWT (Tx); and as further stated.

03/15/85	as	341. ORDER certifying issues for Interlocutory Appeal and Order granting motion to dismiss for lack of standing SIPC's Exchange claim and DENYING motion to dismiss for lack of standing the common law fraud claims, all. (Entered 3/19/85 mailed copies/notices).
03/22/85	as	345. Notice of Order certifying issues for interlocutory appeal and alternatively for entry of Judgment. Pltf.
04/03/85	as	349. ANSWER OF DEFT. ROBERT G. HOLMES, JR. TO First Amended Complaint Deft. Holmes Jr.
04/11/85	avm	377. Pltf's NOTICE OF APPEAL to 9th Circuit Court of Appeals from Order dated 3/19/85. $70 filing and docket fee paid. Mailed copies to all parties.
07/29/85	vu	LODGED copy of judgment from 9th Circuit reversing and remanding US District Court.
08/05/85	vu	451. ORDER that mandate of 9th Circuit Court of Appeals reversing and remanding is filed and spread upon minutes of this US District Court; in accordance with mandate, dismissal against Eugene C. Ferri, Jr. and Mobile International Corp. is vacated; Pltfs granted 30 days in which to further amend their pleadings as against said Defts. (Entered 8/9/85); Mailed copies to parties.

02/26/87	esl	734. Court ORDERS from 9th Circuit Court of Appeals reversing and remanding appeal filed and spread. MO. (N/R) (Entered 2/27/87).
02/26/87	la	LODGED proposed order from 9th Circuit Court of Appeals judgment reversed and remanded.
08/12/88	bc	1273. Exhibits to motion of Deft. for Summary Judgment on issue of causation; declaration of Richard Walker. deft. Robert Holmes Jr.
08/15/88	bc	1274. Exhibits to motion of Deft. Holmes for Summary Judgment on issues of claim asserted under the RICO Act. Deft. Holmes.
08/15/88	bc	1275. Notice of motion and motion for Summary Judgment; returnable 10/17/88 at 10:00 a.m. Deft. Holmes. LODGED prop statement of uncontroverted Facts and Conclusions of law. LODGED prop Summary Judgment.
08/15/88	bc	1276. Memo of Points and Authorities in support of motion for Summary Judgment. Deft. Holmes.

08/15/88	bc	1277. Notice of motion and motion for Summary Judgment with respect to claims asserted under the racketeer influenced and corrupt organizations act. Returnable 10/17/88 at 10:00 a.m. Deft. Holmes. LODGED prop statement of uncontroverted Facts and Conclusions of law. LODGED prop Summary Judgment
08/15/88	bc	1278. Memo of Points and Authorities in support of motion for Summary Judgment. Deft. Holmes.
08/15/88	bc	1279. Exhibits to motion for Summary Judgment. Deft. Holmes.
08/15/88	r/s	1281. Notice of Motion and motion for Summary Judgment issue of causation, returnable 10/17/88 at 10:00 a.m. Deft. Robert Holmes, Jr.
08/18/88	r/s	1282. P/S of exhibits to motion by personal service to Joel A. Bonner, Karen Marse, and Marc Seltzer on 8/15/88. Deft. Robert Holmes, Jr.
08/18/88	r/s	1283. P/S statement of uncontroverted facts by personal service to Joel A. Bonner, Karen Maarse, and Marc Seltzer on 8/15/88. Deft. Robert Holmes, Jr.

08/18/88	r/s	1284. P/S uncontroverted facts and conclusions of law by personal service to Joel A. Bonner, Karen Maarse, & Marc Seltzer on 8/15/88. Deft. Robert Holmes.
09/16/88	r/s	1290. Amended Notice of Motion and motion for Summary Judgment that SIPC lacks standing to assert claims under 1934 Securities Exchange Act, Section 10(b) and Rule 10b-5. Deft. Robert G. Holmes, Jr.
09/21/88	r/s	1308. Opposition to Deft. Holmes motion for Summary Judgment for lack of causation. Pltf Securities Investor Protection Corp.
09/21/88	r/s	1309. Declaration of John B. Torkelson support of pltf opposition to Deft. Holmes motion for Summary Judgment. Pltf Securities Investor Protection Corp.
09/21/88	r/s	1310. Declaration of James C. Foley support of opposition of Pltf, Pltf Securities Investor Protection Corp.
09/21/88	r/s	1311. Pltf statement of genuine issues of material facts, pltf Securities Investor Protection Corp.
09/21/88	r/s	1315. Statement of genuine issues of material facts, Pltf Securities Investor Protection Corp.
09/21/88	r/s	1317. Statement of background and facts, Pltf Securities Investor Protection Corp.
09/21/88	r/s	1318. Statement of genuine issues of material facts, Pltf SIPC.

09/21/88 r/s 1319. Memo of Points and Authorities opposition to Deft. Holmes motion for Summary Judgment, Pltf. SIPC.

09/21/88 r/s 1321. Memo of law in Joinder with pltf opposition to Deft. Holmes memo of Points and Authorities support motion Summary Judgment with respect to claims under racketeer, pltf Randall Cain.

09/22/88 r/s 1293. Appendix of evidence in support of statement of background and facts in opposition to Holmes motions for Summary Judgment, Vol. I, Pltf Securities Investor Protection Corp.

09/22/88 r/s 1294. Appendix of evidence in support of statement of background and facts in opposition to Holmes motions for Summary Judgment, Vol. II, Pltf Securities Investor Protection Corp.

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09/22/88 r/s 1297. Appendix of evidence in support of statement of background and facts in opposition to Holmes motions for Summary Judgment, Vol. V, Pltf Securities Investor Protection Corp.

09/22/88 r/s 1298. Appendix of evidence in support of statement of background and facts in opposition to Holmes motions for Summary Judgment, Vol. VI, Pltf Securities Investor Protection Corp.

09/22/88 r/s 1299. Appendix of evidence in support of statement of background and facts in opposition to Holmes motions for Summary Judgment, Vol. VII, Pltf Securities Investor Protection Corp.

09/22/88 r/s 1302. Memo of Points and Authorities in opposition to Deft. Holmes motion for Summary Judgment with respect to claims under Racketeer Influenced & Corrupt Organization Act.

09/26/88 r/s 1304. P/S of Plaintiffs appendix of evidence support of statement of background and facts in opposition to Holmes motion for Summary Judgment, Vols 1-7. by mail on 9/22/88 to (attached list). Pltf Securities Investor Protection Corp.

09/26/88 r/s 1305. P/S of Pltf appendix of evidence support of statement of background and facts in opposition to Holmes motion for Summary Judgment, Vols 1-7, by personal service 9/22/88 to Robert G. Holmes, Jr., for Deft. Law Offices of Buchalter, Nemer, Fields & Younger.

09/26/88 r/s 1306. P/S of Pltf appendix of evidence support of statement of background and facts in opposition to Holmes motion for Summary Judgment, Vols 1-7, by personal service to Frandzel & Share for Defts. Dash Industries Inc., Jay Dash and Phillip Dash, Pltf Securities Investor Protection Corp.

09/26/88 r/s 1307. P/S of Pltf appendix of evidence support of statement of background and facts opposition to Holmes motion for Summary Judgment, Vols 1-7, by mail on Sept, 1988 to Lester L. Levy, Esq. Pltf Securities Investor Protection Corp.

09/29/88 r/s 1320. Memo regarding Deft. Holmes motion for Summary Judgment that SIPC lacks standing to assert claims. Pltf Randall A. Cain.

09/30/88 r/s 1322. Supplemental appendix of evidence support statement of background, pltf Securities Investor Protection Corp.

10/13/88 r/s 1326. Reply to Pltf opposition to motion for Summary Judgment, Deft. Robert Holmes.

10/13/88 r/s 1327. Reply memo with respect to claims under racketeer influenced, Deft. R. Holmes, Jr.

10/13/88 r/s 1328. Reply to Plaintiffs opposition to motion for Summary Judgment that SIPC lacks standing, Deft. Holmes, Jr.

10/24/88 r/s 1337. Surreply to Holmes reply to pltf opposition to Summary Judgment motion on causation, Pltf Securities.

10/24/88 r/s 1338. MO: Summary Judgment motions taken under submission. Court Order Dash dfts motion to continue Pretrial Conference GRANTED in part. Pretrial Conference date is continued to 01/-9/89, @ 03:00 PM. Court Order case set for Status Conference on 12-05-88, @ 01:30 PM. Court directs attorney for Dash to prepare form of Order.

10/26/88 r/s 1340. Statement of Uncontroverted facts in support of Motion for Summary Judgment that SIPC lacks standing to assert claims – Deft. Robert G. Holmes, Jr.

10/26/88 r/s 1341. Judgment and Order for Partial Summary Judgment – IT IS ORDERED that SIPC lacks standing to assert claims under Securities Exchange Act of 1934 against Robert G. Holmes, Jr. SIPC's 2nd & 16th claims for relief against Holmes are DISMISSED in entirety with prejudice. (Entered 10/28/88).

10/31/88 esl 1342. STATEMENT OF UNCONTROVERTED FACTS & CONCLUSIONS OF LAW & ORDER. (Entered 11/3/88).

10/31/88 esl 1343. ORDER granting Summary Judgment (RICO claims) it is hereby ORDERED that deft. G. Holmes, Jr.'s motion for Summary Judgment with respect to claims asserted granted and such claims are hereby DISMISSED. (Entered 11/3/88).

10/31/88 esl 1344. Summary Judgment (HOLMES) ORDER that this motion for Summary Judgment is granted and judgment shall be entered forthwith as requested in the motion in favor of deft. Robert G. Holmes, Jr. and against Pltfs. (Entered 11/3/88) Mailed copies to all parties.

11/28/88 r/s 1352. Notice of Motion and motion for Order granting leave to file interlocutory appeal, and stay all proceeds pending appellate review, returnable 12/19/88 at 9:30 a.m. Pltf Securities Investors.

11/28/88 r/s 1353. memorandum of Points and Authorities support of Motion for leave to file interlocutory, Pltf Sec. Invest Protect

11/28/88 r/s 1354. Notice of Joinder and joinder in motion of pltf for leave to file interloc, Pltfs

12/05/88 r/s 1355. Memo re motion for leave to file interlocutory appeal, or entry of final judgment, Deft. Holmes.

12/06/88 r/s 1356. Statement re SIPC's Motion for leave to file interlocutory appeal, etc., Defts. Diamond, & McNeil.

12/09/88 r/s 1364. Reply brief in support of motion for Order Granting leave to file interlocutory appeal, or enter Final Judgment and for stay of all proceedings pending appellate review, Pltf

12/16/88 r/s 1365. Surreply brief of Robert G. Holmes, Jr. re Pltf motion for leave to file interlocutory appeal, or entry of final judgment, Deft. Holmes.

12/19/88 r/s 1366. Response to surreply of Holmes re pltfs motion for leave to file interlocutory appeal, Pltf

12/19/88 r/s 1368. MO: Order motion to file interlocutory appeal GRANTED and motion for general stay also GRANTED with three exceptions. Stay applies to Class Action as well, RP

12/22/88	am	1369.	ORDER that each of the order's granting Summary Judgment and the summary Judgment in favor of Deft. Robert G. Holmes, Jr., against pltfs disposing all claims by pltfs against defendant Holmes hereby is amended to include an express determination that there is no good reason for delay and an express direction for the entry of judgment. Further that all further proceedings in this action and in the action consolidated herewith are stayed pending appeal or until otherwise ordered by the court except Any activity including motions, stipulations and orders to negotiate and complete any settlement; Mont. for entry of default judgment against Deft. Lugo and any discovery activity with the prior approval for the court for good cause shown for an exception from the stay. (Entered 12/29/88) copy to parties.
01/06/89			Notice of Appeal of Plaintiff SIPC.
01/10/89		1370.	Notice of Appeal of Plaintiff SIPC.
01/20/89		1373.	Notice of Appeal; U.S.D.C. Docket (Filed in U.S.D.C.)
04/13/90	r/s	1414.	Notice of joinder in motion for Order determining class settlement and barring claims against settling deft Robert G. Holmes, Jr., deft

04/30/90	r/s	1416.	MO: crt approves partial settlement and bars claims against settling defts stated above, including Holmes. Court grants with out argument pltfs application for reimbursement of costs and expenses., court takes under submission Trustees request to audit claims and the plft application for award attorney fees, LAH
05/02/90	r/s	1417.	FINAL JUDGMENT AND ORDER DISMISS: court approves settlement as set forth in Stipulation; Court directs entry of this Final Judgment and Order of dismissal as a final judgment.
		1418.	ORDER determining class settlement to be in good faith and barring claims against settling defts Magnetic Technologies Corp, Gordon McNeil, Isadore Diamond, Seymour Vigman, and Aero Systems, Inc., Defts
10/01/90	jh		LODGED cc Order from 9th Circuit Court of Appeals reversing and remanding.
10/05/90	jh	1425.	MO: Upon the filing of the mandate of the Court of Appeals, reversing the grant of Summary Judgment against pltfs on THE RICO claim, ORDER Status Conference is set for 10/29/90 at 3 p.m.; any party may file a separate Status Conference report Not Later Than 10/22/90, C/R none.

10/05/90	jh	1426. MO: Court ORDER that mandate of 9th Circuit Court of Appeals the record reflects that costs of the prevailing party were taxed by the 9th Circuit Court of Appeals in the amount of $1,819.02 on 9-25-90 (89-55094) and $3,730.43 on 9-25-90 (89-55094 and 89-55128) is hereby filed and spread upon the minutes of this District Court (ENT 10-10-90)
10/22/90	lp	1430. Stipulation and ORDER staying proceedings pending application for review.

COURT OF APPEALS

02/03/89	DOCKETED CAUSE AND ENTERED APPEARANCES OF COUNSEL. Sent appellant(s) civil appeals docketing statement, setting schedule as follows: Fee payment is due 2/17/89; CADS due 2/17/89 for Stephen C. Taylor; appellant's designation of Reporters Transcript is due 1/17/89 for Securities Investor; appellee's designation of Reporters Transcript is due 1/26/89 for Robert G. Holmes; appellant shall order transcript by 2/6/89 for Securities Investor; court reporter shall file transcript in District Court by 3/8/89 for Patt Lawler; certificate of record shall be filed by 3/15/89; appellant's opening brief is due 4/24/89 for Securities Investor; appellees' brief is due 5/24/89 for Robert G. Holmes; appellants' reply brief is due 6/7/89 for Securities Investor. [89-55094] (jhc) [89-55094]

02/16/89	Filed certificate of record on appeal Reporters Transcript filed in District Court N/T. [89-55094] (cck) [89-55094]
08/04/89	Filed original and 15 copies Appellant Securities Investor in 89-55094, Appellant Laurance A. Schroeder in 89-55128, Appellant Eugene W. Bell in 89-55128 Joint opening brief 50 pages, and five excerpts of record in 1 volume; served on 8/1/89 [89-55094, 89-55128] (jw) [89-55094, 55128]
08/04/89	Filed original and 15 copies Trustee's separate opening brief 20 pages, served on 8/1/89 [89-55094, 89-55128] (jw) [89-55094, 89-55128]
08/09/89	Filed SEC in 89-55094, SEC in 89-55128's motion for leave to file a brief, Amicus Curiae, out of time, (PROMO to CONFATT); served on 8/8/89 [1643832] [89-55094, 89-55128] (jw) [89-55094, 89-55128]
09/06/89	Filed order (NOONAN): The motion to file a brief, amicus curiae, late is granted. The brief received by the court shall be filed. Apellees motion for an enlargement of brief length is denied. [1643832-1] in 89-55094, 89-55128 [89-55094, 89-55128] (jw) [89-55094, 89-55128]

09/06/89	Filed original and 15 copies SEC in 89-55094, SEC in 89-55128's amicus brief of 15 pages; served on 8/8/89, previously received. [89-55094, 89-55128] (jw) [89-55094 89-55128]
10/05/89	Filed original and 15 copies appellee Robert G. Holmes in 89-55094, Robert G. Holmes in 89-55128's 75 pages brief, served on 10/3/89 [89-55094, 89-55128] (jw) [89-55094 89-55128]
10/27/89	Filed original and 14 copies Securities Investor in 89-55094 reply brief, 36 pages, served on 10/20/89 [89-55094, 89-55128] (ec) [89-55094 89-55128]
01/25/90	CALENDARED: PASADENA, MARCH 5, 1990 1:30 p.m. Courtroom 3 [89-55094, 89-55128] Case will now be heard on 3/6/90. (aw) [89-55094 89-55128]
03/06/90	ARGUED AND SUBMITTED TO: SCHROEDER, THOMPSON, TROTT [89-55094, 89-55128] (jhc) [89-55094 89-55128]

03/20/90	Filed order (SCHROEDER, THOMPSON, TROTT,): Securities Investor Protection Corporation and trustees Eugene W. Bell and Laurence A. Schroeder are hereby ordered to file within ten days of the date of this order supplemental excerpts of record to consist of the following documents: (1) pltfs'/Aplts' Statement of Background and Facts (clerk's record 1317); (2) Declaration of James C. Foley (clerk's record 1310); and (3) Declaration of John B. Torkelson (clerk's record 1309) [89-55094, 89-55128] (dmd) [89-55094 89-55128]
03/29/90	Filed 5 copies of Appellant Securities Investor in 89-55094 supplemental excerpts of record on appeal in 1 volumes, per order of 3/20/90, (PANEL) (jw) [89-55094 89-55128]
03/30/90	FILED, AS OF 2/16/89, CERTIFIED RECORD ON APPEAL IN 4 VOLS. (TOTAL): 4 CLERKS RECORDS (ORIG) [89-55094] [89-55094] (jw) [89-55094]
08/03/90	FILED OPINION: REVERSED REMANDED (Terminated on the Merits after Oral Hearing; Reversed; Written, Signed, Published. SCHROEDER; THOMPSON, author; TROTT.) FILED AND ENTERED JUDGMENT. [89-55094, 89-55128] (ck) [89-55094 89-55128]

09/25/90	MANDATE ISSUED to include costs. [89-55094, 89-55128] (jw) [89-55094 89-55128]
11/09/90	Received notice from Supreme Court: petition for certiorari filed Supreme Court No. 90-727 filed on 11/1/90. [89-55094] (dmd) [89-55094]

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,	)	CASE NO. 83-4742-AWT (Tx)
Plaintiffs,	)	FIRST AMENDED COMPLAINT FOR DAMAGES:
vs.	)	

SEYMOUR VIGMAN, AERO SYSTEMS, INC., AEROSONIC CORPORATION, CREDITBANK, INC., DASH INDUSTRIES, INC., HABERICO, INC., HABERS, INC., HABERS, INC., DEFINED BENEFIT PENSION TRUST, IBEBAFIN, S.A., KEOPS, S.A., MAGNETIC TECHNOLOGIES CORPORATION, TALINGO CORPORATION, TULA CORPORATION, MARTIN BLUMENTHAL, JOSE LUIS CALOGNE, aka JOSE LUIS CALONGE RIVAS, DOLORES OWENS CIPPARONE, aka DEE CIPPARONE, JAY DASH, PHILLIP DASH, ISADORE DIAMOND, ELLIOT I. EISEMAN, HERBERT J. FRANK, FRANKIE MAE GARRITY, RODGER W. GARRITY, DAVID S. GOLDMAN, JACK A. HABER, ROBERT G. HOLMES, JR., JOSEPH A. LUGO, JR., ROBERT J. MANSELL, GORDON H. McNEIL, EDWARD P. PRESCOTT, JOSE CAMPRUBI SALA, VELMA SHAW, aka VELMA SHAW MYERS, NETTIE VIGMAN and LAWRENCE WEST, aka LARRY WEST,

Defendants.

A) FOR VIOLATION OF THE SECURITIES EXCHANGE ACT OF 1934 [15 U.S.C. §§ 78a, *et seq.*];

B) FOR VIOLATION OF THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT [18 U.S.C. §§ 1961, *et seq.*];

C) BREACH OF FIDUCIARY DUTY; and

D) FRAUD.

DEMAND FOR JURY TRIAL

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FIRST AMENDED COMPLAINT

Plaintiffs Securities Investor Protection Corporation; Eugene W. Bell, Trustee for the liquidation of Joseph Sebag Incorporated; and John L. Britton, Trustee for the liquidation of First State Securities Corporation allege as follows:[1]

JURISDICTION

1. This Court has jurisdiction over the subject matter of this action and the defendants named herein under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961, *et seq.*, ("RICO"), the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, *et seq.*, (the "Exchange Act") and 28 U.S.C. § 1331. This Court further has jurisdiction over all state and common law claims asserted herein by virtue of its pendant jurisdiction in that such claims arise from a common nucleus of operative fact.

VENUE

2. Venue of this action lies in the Central District of California by virtue of 18 U.S.C. § 1965 and 15 U.S.C. § 78aa. Each defendant sued herein committed the statutory and/or common law violations alleged in this First Amended Complaint by the use of means or

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[1] This First Amended Complaint is filed pursuant to this Court's Memorandum Order on Motions to Dismiss entered May 30, 1984. The amendments made in compliance with that Order are without prejudice to all plaintiff's rights of appeal.

instrumentalities of interstate commerce or of the mails, or of facilities of the over-the-counter securities market, and

A. committed acts or engaged in the transactions constituting the violations in the Central District of California; or

B. at all relevant times was found, or is an inhabitant or a resident or transacts his (her) affairs in the Central District of California; or

C. the ends of justice require that the action be defended in this Court.

3. PARTIES PLAINTIFF

A. Securities Investor Protection Corporation.

Plaintiff Securities Investor Protection Corporation ("SIPC") is non-profit corporation created by the Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa, *et seq.* ("SIPA"). SIPC's members consist of broker-dealers registered under the Securities Exchange Act of 1934. SIPA specifically authorizes SIPC "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any state, Federal, or other court." 15 U.S.C. § 78ccc(b)(1). In addition to the powers conferred under SIPA, SIPC has the powers of a non-profit corporation conferred by the District of Columbia non-profit corporations code. 6 D.C. Code § 29-501, *et seq.* (1981). To protect customers of securities broker-dealers from losses resulting from the financial failure of the broker-dealers,

SIPA empowers SIPC to commence liquidation proceedings in a United States District Court when SIPC determines that the broker-dealer has failed or is in danger of failing to meet its obligations to its customers and one or more of four specific conditions, including failure to maintain net capital at statutorily-required levels, exists.

B. Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Incorporated.

Joseph Sebag Incorporated, was a Delaware corporation doing business in interstate commerce as a securities broker-dealer registered with and licensed by the National Association of Securities Dealers ("NASD") with its principal place of business in Los Angeles, California. Joseph Sebag Incorporated, owned all the outstanding stock of Investors Financial Services, Inc. ("IFS"), which had offices located in Los Angeles and Irvine, California, and carried all customer accounts on behalf of IFS on a fully disclosed basis. Like Joseph Sebag Incorporated, IFS was also engaged in interstate commerce as a securities broker-dealer. In July, 1981, and at various periods during the preceding five years, Joseph Sebag Incorporated, and IFS (hereinafter collectively referred to as "Sebag") traded on behalf of its customers and for Sebag's own account the following over-the-counter ("OTC") securities, among others: Aerosonics Corporation ("Aerosonics"), Aero Systems, Inc. ("Aero Systems"), Bunnington Corporation ("Bunnington"), Creditbank, Inc. ("Creditbank"), Dash Industries, Inc. ("Dash"), Intercontinental Diamond Corporation ("Intercontinental Diamond") and Osrow Products Corporation ("Osrow

Products"). All of these issuers were themselves engaged in interstate commerce.

On July 27, 1981, Eugene W. Bell ("Bell") was, upon application by SIPC and a finding that the customers of Sebag were in the need of the protection afforded by SIPA, appointed trustee for the liquidation of Sebag by the Honorable Malcolm M. Lucas, Judge of the United States District Court for the Central District of California. At all times subsequent to July 27, 1981, Bell has been the duly qualified and acting trustee for the liquidation of Sebag possessing all of the rights and remedies afforded a trustee under SIPA and those sections of the Bankruptcy Code (11 U.S.C. § 101, *et seq.*) not inconsistent with SIPA.

C. John L. Britton, Trustee for the Liquidation of First State Securities Corporation.

First State Securities Corporation ("FSSC") was a Delaware corporation engaged in interstate commerce as a securities broker-dealer with its principal place of business in North Miami, Florida. In July 1981, and at various periods during the preceding five years FSSC traded the following issues, among others, on behalf of its customers and for its own account: Aerosonic, Aero Systems, Bunnington, California Leisure Products, Inc. ("California Leisure"), Creditbank, Dash and Osrow Products.

On July 24, 1981, John L. Britton ("Britton") was, upon application by SIPC and a finding that the customers of FSSC were in need of the protection afforded by SIPA, appointed trustee for the liquidation of FSSC by the Honorable James Laurence King, Judge of the United States District Court for the Southern District of Florida.

At all times subsequent to July 24, 1981, Britton has been the duly qualified and acting trustee for the liquidation of FSSC possessing all of the rights and remedies afforded a trustee under SIPA and those sections of the Bankruptcy Code (11 U.S.C. §101, *et seq.*) not inconsistent with SIPA.

4. Pursuant to SIPC's statutory obligations to advance funds needed to satisfy net equity claims of the customers of Sebag and FSSC and to advance funds for costs and expenses of administration, SIPC has paid in excess of the following sums in the liquidation proceedings to date:

Sebag – $12,020,877

FSSC – $ 895,790.

SIPC continues to pay such sums as are appropriate under its statutory authority. SIPC will amend this First Amended Complaint at the time of trial to show all such sums paid.

PARTIES DEFENDANT

5. The defendants are as follows:

A. *Rico Defendants*:[2] The following defendants planned, conducted or knowingly participated in the conspiratorial pattern of racketeering activity involving the fraudulent manipulation of the market prices of the over-the-counter securities hereinafter alleged:

---

[2] Defendants against whom plaintiffs assert claims for relief under the RICO Act, 18 U.S.C. §§ 1961, *et seq.*

(1) Corporate RICO Defendants:

Aero Systems, Inc. ("Aero Systems")

Second, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Robert G. Holmes, Officer and Director.

Aerosonic Corporation ("Aerosonic")

First, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Herbert J. Frank and David S. Goldman, Officers and Directors.

Creditbank, Inc. ("Creditbank")

Fourth, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Jose Luis Calonge, aka Jose Luis Calonge Rivas, Jose Camprubi Sala, Joseph A. Lugo, Jack A. Haber, Directors.

Dash Industries, Inc. ("Dash")

Fifth, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Martin Blumenthal, Jay Dash, Phillip Dash, Officers and Directors.

Ibebafin, S.A.

Fourth and Seventeenth Claims for Relief.

Keops, S.A.

Fourth and Seventeenth Claims for Relief.

Magnetic Technologies Corporation [formerly known as Bunnington Corporation ("Bunnington")]

Third, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Isadore Diamond (Chairman

of the Board); Seymour Vigman, Gordon H. McNeil, Officers and Directors.

Talingo Corporation (Talingo")

First, Third, Fourth, Sixth and Seventeenth Claims for Relief.

Tula Corporation ("Tula")

First, Third, Fourth, Sixth and Seventeenth Claims for Relief.

(2) Individual RICO defendants who are residents of the Central District of California:

Garrity, Frankie Mae

Eleventh and Seventeenth Claims for Relief – wife of defendant Garrity, registered principal of IFS; maintained securities accounts at Sebag.

Garrity, Rodger W. ("Garrity")

First through Sixth, Seventeenth, Eighteenth and Nineteenth Claims for Relief – husband of defendant Frankie Mae Garrity, registered representative of IFS.

Vigman, Nettie

Tenth and Seventeenth Claims for Relief – wife of defendant Seymour Vigman, sister of defendant Isadore Diamond; maintained securities accounts at Sebag and FSSC.

Vigman, Seymour ("Vigman")

First, Second, Third, Fifth, Sixth, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Officer, shareholder and Chairman of the Executive Committee of defendant Bunnington, a "controlling person" of Bunnington within the meaning of 15 U.S.C. §§ 77o and 78t; husband of defendant Nettie Vigman; brother-in-law of defendant Isadore Diamond.

(3) Individual RICO defendants who transacted their affairs within the Central District of California at all relevant times herein:

Frank, Herbert J. ("Frank")

First, Sixteenth, Seventeenth and Nineteenth Claims for Relief – President, Chairman of the Board of Directors; "controlling person" of defendant Aerosonic.

Holmes, Robert G., Jr. ("Holmes")

Second, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Officer, Director and "controlling person" of defendant Aero Systems, Inc.

Lugo, Joseph A., Jr. ("Lugo")

First through Sixth, Seventeenth, Eighteenth and Nineteenth Claims for Relief – Officer, Director, shareholder and registered principal of FSSC; Director and "controlling person" of defendant Creditbank.

Shaw, Velma (aka Velma Shaw Myers) ("Shaw")

First, Second, Third, Fifth, Sixth, Seventeenth, Eighteenth and Nineteenth Claims for Relief – registered principal of IFS; resident of the Central District of California.

(4) Individual RICO defendants who knowingly assisted, participated or conspired with other defendants in the consummation of the fraudulent, manipulative scheme hereinafter alleged:

Blumenthal, Martin ("Blumenthal")

Fifth, Seventeenth and Nineteenth Claims for Relief – Officer, Director, "controlling person" and shareholder of Dash Industries, Inc.; maintained securities accounts at FSSC.

Calonge, Jose Luis [aka Jose Luis Calonge Rivas] ("Calonge")

Fourth, Seventeenth and Nineteenth Claims for Relief – Chairman of the Board of Directors, majority shareholder and "controlling person" of defendant Creditbank; maintained securities accounts at FSSC; Officer and "controlling person" of JLC CIA Inversionista, S.A.; and "controlling person" of Mobile International Corporation.

Cipparone, Dolores Owens (aka Dee Cipparone) ("Cipparone")

Seventh, Seventeenth and Eighteenth Claims for Relief – registered principal, Officer, Director, shareholder and "controlling person" of FSSC; maintained securities account at FSSC.

Dash, Jay

Fifth, Sixteenth and Seventeenth Claims for Relief – Officer, Director, shareholder and "controlling person" of Dash Industries, Inc.; maintained securities accounts at FSSC.

Dash, Phillip

Fifth, Sixteenth and Seventeenth Claims for Relief – Officer, Director, shareholder and "controlling person" of Dash Industries, Inc.; maintained securities accounts at FSSC.

Diamond, Isadore ("Diamond")

Second, Third, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Chairman of the Board of Directors and a "controlling person" of defendant Bunnington; at one material time Director of defendant Aero Systems; brother of defendant Nettie Vigman; brother-in-law of defendant Vigman; maintained securities accounts at FSSC.

Eiseman, Elliot I. ("Eiseman")

Ninth, Seventeenth, Eighteenth and Nineteenth Claims for Relief – Officer, Director, shareholder, "controlling person" and registered principal of FSSC.

Goldman, David S.

First, Sixteenth, Seventeenth and Nineteenth Claims for Relief – Officer, Director and "controlling person" of Aerosonic; maintained securities accounts at Sebag and FSSC.

Haber, Jack A. ("Haber")

Fourth, Fifteenth, Sixteenth and Seventeenth Claims for Relief – Director and "controlling person" of Creditbank; Officer and "controlling person" of Habers, Inc., and Haberico, Inc.; maintained and/or controlled securities accounts at Sebag and FSSC.

McNeil, Gordon H. ("McNeil")

Third, Sixteenth, Seventeenth and Nineteenth Claims for Relief – President, Director and "controlling person" of defendant Bunnington.

Sala, Jose Camprubi ("Sala")

Fourth, Fourteenth, Sixteenth and Seventeenth Claims for Relief – honorary Chairman of the Board and "controlling person" of defendant Creditbank; maintained securities account at FSSC.

B. *Other Defendants:* The following defendants knowingly participated or aided and abetted in manipulating one or more of the securities as hereinafter alleged more particularly in plaintiffs' specific Claims for Relief:

(1) Corporate Defendants:

Haberico, Inc. ("Haberico")

Fifteenth Claim for Relief – maintained securities accounts at FSSC and Sebag; wholly-owned by Jack A. Haber; controlled by defendant Jack A. Haber.

Habers, Inc.,

Fifteenth Claim for Relief – Jack A. Haber, Officer.

Habers, Inc., Defined Benefit Pension Trust

Fifteenth Claim for Relief – maintained securities accounts at FSSC; accounts controlled by Jack A. Haber.

(2) Individual Defendants:

Mansell, Robert J. ("Mansell")

Eighth Claim for Relief – FSSC margin clerk.

Prescott, Edward P. ("Prescott")

Thirteenth and Eighteenth Claims for Relief – Officer, Chairman of the Board of Directors, "controlling person" and registered principal of Sebag; resident of the Central District of California.

West, Lawrence (aka Larry West) ("West")

Twelfth Claim for Relief – resident of the Central District of California; maintained securities accounts at Sebag and FSSC.

BACKGROUND OF THE RACKETEERING ENTERPRISE

6. The defendants, through acts, transactions and practices hereinafter described, using means or instrumentalities of interstate commerce including the mails, telephones, wires, broker-dealers and the facilities of over-the-counter securities markets, carried out an ongoing pattern of concerted activity to manipulate and artificially inflate the prices of various over-the-counter securities of corporations engaged in interstate commerce in which numerous defendants held large positions. The purpose, in part, of the manipulative conduct hereinafter alleged was to artificially inflate the prices of these securities so that the defendants could reap substantial illicit profits from the purchase, sale and repurchase of the securities on the OTC market, re-invest the proceeds from their sales in other entities engaged in interstate commerce, acquire interests in entities engaged in interstate commerce and induce others to purchase these securities.

7. The "manipulative scheme," began in or about June, 1964, and continued by the associations and acts hereinafter alleged through commencement of the liquidation proceedings of Sebag and FSSC in July, 1981. It was carried out by the concerted actions of issuer corporations, certain of their officers and directors, registered broker-dealers, registered representatives and employees of broker-dealers, securities traders and participating investors. Eventually, the fraudulent manipulations of the following OTC securities caused the net capital of Sebag and FSSC to fall below statutorily-required levels, thereby exposing their customers and SIPC to substantial risks and requiring that trustees be appointed to liquidate Sebag and FSSC under the provisions of SIPA:

Aero Systems;

Aerosonic;

Bunnington (presently Magnetic Technologies);

Creditbank;

Dash Industries; and

Osrow Products.

* * *

SECOND CLAIM FOR RELIEF BY PLAINTIFFS AGAINST DEFENDANTS AERO SYSTEMS, LUGO, GARRITY, SHAW, HOLMES, VIGMAN, AND DIAMOND

(Securities Fraud)

[17 C.F.R. § 240.10b-5; 15 U.S.C. § 78j(b)]

75. Plaintiffs incorporate herein by reference paragraphs 1 through 74 of this First Amended Complaint.

76. At all times relevant herein, defendant Homes was an officer, controlling person, within the meaning of 15 U.S.C. §§ 77o and 78t, principal shareholder and director of defendant Aero Systems. Defendant Diamond was, at relevant times herein, an officer, director, shareholder and controlling person of Aero Systems. Aero Systems at all times relevant transacted its affairs within the Central District of California. Defendant Diamond was also, at all times relevant herein, an officer, director and controlling person, within the meaning of 15 U.S.C. §§ 77o and 78t, of defendant Bunnington. All of these defendants owed a duty to the shareholders and purchasers and sellers of these companies' securities and the investing public to refrain from the conduct herein alleged.

77. As alleged above, defendant Aero Systems acquired DCS Financial and DCS Financial's subsidiary Springwater Manufacturing in July, 1976. On or about March 1, 1978, Aero Systems transferred Springwater Manufacturing to Honeoye Industries, Inc., a wholly-owned subsidiary of defendant Bunnington for $250,000 cash and the transfer to Aero Systems of a $350,000 note receivable.

78. Aero Systems included the operations of Springwater Manufacturing in Aero Systems' consolidated

statement of income for the fiscal year ended February 28, 1977, from the date of its acquisition effective July, 1976. Springwater Manufacturing's sales of $690,863 represented 14% of the reported total sales and operating revenue of Aero Systems for the fiscal year; and Springwater Manufacturing's income before income taxes of $46,803 was 47% of Aero Systems' consolidated income before income taxes and extraordinary credit for the fiscal year.

79. As alleged above, Aero Systems transferred Springwater Manufacturing to a Bunnington subsidiary in 1978, allowing Aero Systems to report a gain, in the fiscal year ended February 28, 1979, of $442,346 including income tax benefits. This gain represented 34% of Aero Systems' consolidated net income for that fiscal year.

80. The Aero Systems consolidated statement of income for the fiscal year ended February 28, 1978, reflected the impending sale of Springwater Manufacturing to Bunnington and reported the operations of Springwater Manufacturing on a single line as income from discontinued operations of $100,610 and $18,578 for the fiscal years ended February 28, 1978 and 1977, respectively. These figures represented 35% and 35.3%, respectively, of the income before extraordinary credit in each year.

81. If Aero Systems had not transferred Springwater Manufacturing to Bunnington effective March 1, 1978, and had not reported the operations of Springwater Manufacturing on one line as discontinued operations, sales and operating revenue for the fiscal year ending February

28, 1978, would have been reported as $7,932,038, including $1,609,823 of Springwater Manufacturing's sales. Springwater Manufacturing's sales would have accounted for 20.3% of Aero Systems' total pro-forma revenues.

82. Based on the facts alleged in paragraphs 76 through 81, above, plaintiffs allege that the motive, in part, for the acquisition by Aero Systems of DCS Financial (and its subsidiary, Springwater Manufacturing) was to permit Aero Systems to report improved financial performance with the intent to induce public confidence in and purchases of Aero Systems stock, to employ Aero Systems as a conduit to facilitate Bunnington's eventual acquisition of Springwater Manufacturing, and to place substantial positions of Aero Systems stock in the control of Speyer and defendants Nettie Vigman, McNeil, Blumenthal and Diamond.

83. In or about April, 1980, Aero Systems publicly announced that it had acquired from Colt Electronics Co., Inc. ("Colt Electronics") the exclusive marketing right to a computerized fuel management system for installation in commercial and private aircraft, known as the CD-3000 Fuel Management Computer ("CD-3000"). In conjunction with this acquisition, Aero Systems and Holmes made, or caused to be perpetuated, statements to the public and Aero System stockholders, including, among others, the following:

(a) An April 1, 1980, press release stating that "[t]he potential market for this much needed product includes all multi-engine jet, turbo prop and piston aircraft in the world. Robert G. Holmes, Jr., Aero's President stated

'We plan to market this fuel management computer thru our expanding world wide sales force and thru a selective network of dealers.' ";

(b) An April 23, 1980, press release stating that "Aero Systems plans to lease [the CD-3000] to commercial and business aircraft operators worldwide in exchange for a percentage of actual fuel savings. 'According to industry figures, the airlines alone will spend more than $30 billion for fuel this year,' Robert G. Holmes, Jr., Aero's president, noted.";

(c) A letter to shareholders, signed by defendant Holmes, in its 1980 Annual Report for its fiscal year ending February 29, 1980, stating that "We are very excited with our new 'Aero Systems Fuel Management Computer.' . . . Initial results from business jet users indicate fuel savings to be in the area of 10%. The market for this much needed product includes all multi-engine, turbo-prop and piston aircraft in the world.";

(d) A letter to shareholders, signed by defendant Holmes, in the 1981 Annual Report for fiscal year 1981 ending February 28, 1981, stating that "The excitement over our CD-3000 Fuel Management Computer continues to build as we get closer and closer to realizing its dramatic potential. We are now more convinced than ever about its success. The huge market for this unique new, high technology, energy saving device includes all multi-engine aircraft and helicopters in the world. . . . The CD-3000 has been installed in a variety of business jets and users estimate the fuel savings to be in the area of 10%. . . . In 1980 the major trunk airlines spent more than $30 billion for fuel . . . and the timing for introduction of our fuel saving computer couldn't be better.";

(e) Exxon *Aviation News*, October 24, 1980: "Aero Systems, Inc. is leasing an aircraft fuel

management computer from Colt Electronics to commercial and business aircraft operators worldwide in exchange for a percentage of actual fuel savings.";

(f) *Portfolio Letter*, Vol. II, no. 39, September 29, 1980, stating that "Aero President *Robert Holmes, Jr.*, told PL he had 400 'serious' prospects for the CD-3000. 'We stumbled across a new market for the CD-300[sic],' he added, explaining that the large helicopters that shuttle back and forth to off-shore oil rigs have very little in the way of cockpit-based fuel monitors."

(g) A Miami Herald article of September 29, 1980 quoting defendant Holmes: "We think this is a wonderful product for the times . . . Our tests show that it can result in fuel savings of up to 10 per cent."; and

(h) January 12, 1981, press release, signed by defendant Holmes, stating that "[t]he response to our unique new fuel saving computer has been excellent. Several airlines are on the verge of placing orders for the CD-3000 Fuel Management Computer and we have many pending orders from the business aircraft market."

These misleading statements to the public created an impression that sales of the computer had already been made, that large numbers of additional sales were imminent and that such sales would be profitable to Aero Systems. These statements were made with the intent, in part, of generating public interest in the Aero Systems stock and thereby inducing purchases of the stock.

84. At the time the statements were made, defendants Aero Systems and Holmes knew that the statements were false and misleading or were made in

reckless disregard of the truth, and that the statements omitted to include material facts necessary to make the statements not misleading in light of the circumstances under which they were made, in that:

(a) No sales of the CD-3000 had been made and there was no reasonable prospect of sufficient sales in the near future to yield the represented profits.

(b) The statements vastly overstated the potential market for this product. Rather than including all multi-engine aircraft in the world, the market was limited to only aircraft regularly used for flights of a certain duration and above a certain altitude.

(c) The statements created the false impression that Aero Systems would reap a bonanza consisting of a significant percentage of the $3 billion that trunk airlines would allegedly "save" using the CD-3000.

(d) There was no reasonable factual basis for the projected 10% fuel savings.

(e) Aero Systems failed to disclose that the agreement with Colt Electronics required an immediate payment of $100,000 to Colt Electronics and an additional immediate purchase by Aero Systems of $87,000 in equipment from Colt Electronics.

(f) Aero Systems failed to disclose that it was obligated to purchase $1,000,000 in equipment from Colt Electronics at the rate of $200,000 bi-annually as a condition precedent to retention of the rights to the CD-3000.

85. Beginning no later than September, 1980 and continuing through July, 1981, Aero Systems, acting

through defendant Holmes, also caused false or recklessly misleading material representations regarding the corporation's sales and projected earnings for fiscal year 1981 and future sales and earnings of the CD-3000 to be publicly disseminated or perpetuated through newspapers, periodicals and securities analysts. These knowing misrepresentations, intended to induce public confidence in and purchases of Aero Systems securities included, among others, the following:

> (a) Statements in Moore & Schley, Cameron & Co. Research Department publication, by Jules Augus, dated September 25, 1980, that Aero Systems' "area of greatest current excitement is the acquisition in April, 1980 of the worldwide marketing and distribution rights for a new aircraft fuel management computer system – the CD-3000. The system has indicated, in early testing, fuel savings in the area of 10%. This unique system's fuel savings could pay for the cost of the computer ($7,500 or more) on a business aircraft in three months and for a commercial jet installation in less than three weeks. This system . . . has a potential market of 50,000 private aircraft, 5,500 commercial aircraft, and for a large number of military aircraft . . . The Company is currently working on a foreign deal which could result in the sale of 250-400 units . . . The potential to Aero from this new high technology product could eventually provide greater revenues than from its current business alone.'";

(b) Statements in Wheat First Securities *Technology Group* publication, November 6, 1980, that Aero Systems would "achieve $20 million in sales for this year, with earnings per share of $0.27, and exceed the $50 million sales level within two years" and that the "CD-3000 is a

unique new energy saving device suitable for any jet or propeller aircraft, as well as helicopters.";

(c) Statements in undated Porter Le Vay & Rose, Inc. *Aero Systems, Inc. Information Report* that fiscal year 1981 sales would reach $20 million with earnings close to $.30 per share even without the impact of CD-3000 sales;

(d) Statements in Alan J. Wax column, New York Post, October 13, 1980, attributed to Jules Augus, that Aero Systems had made a significant number of sales of the CD-3000 including an order of 250 units by a foreign government; and

(e) Statements in Dick Davis' column, Miami Herald, November 16, 1980, attributed to Jules Augus, that the CD-3000 "can produce fuel savings of up to 10 per cent – savings that can pay for the cost of the computer in three weeks to three months, depending on the aircraft."

86. The above material misstatements and factual omissions were false and misleading for, among other things, the following reasons:

> (a) The statements misrepresented the interest of potential buyers in the CD-3000 and omitted to state that the prospective market for the CD-3000 was very limited.
>
> (b) There was no reasonable basis for the projected sales and future earnings and there was no reasonable basis for the projection that future sales would substantially add to the profitability of Aero Systems.
>
> (c) There was no reasonable factual basis for the estimated 10% fuel savings that purportedly could be achieved by users of the CD-3000.

(d) Aero Systems had not sold 250 units of the CD-3000 as of October, 1980.

87. Plaintiffs are informed and believe, based upon a December 9, 1982 Aero Systems press release, and thereon allege, that contrary to the above-alleged public pronouncements made by or at the direction of defendants Aero Systems and Holmes, Aero Systems made no sales of the CD-3000 until late 1982, when 2 sales were made.

88. In or about August, 1980, defendant Garrity traveled to Florida to confer with defendant Lugo. The market price of Aero Systems stock substantially increased thereafter from a price of $2 5/8 bid, $2 3/4 ask in August, 1980 to a price of $7 bid, $7 1/8 ask in September, 1980. Plaintiffs are informed and believe, and thereon allege, that the purpose of this meeting was to discuss the methods by which defendants Lugo and Garrity would effect the manipulation of that stock and thereby raise its price.

89. Plaintiffs are informed and believe, and thereon allege, that defendants Lugo, Garrity and Shaw, with knowledge of the above omissions and that the above material misstatements and misrepresentations were false or in reckless disregard of the truth, worked in concert with defendants Aero Systems, Holmes, Diamond, Vigman and Nettie Vigman to raise the price of the Aero Systems securities by employing these misrepresentations and omissions as an artifice to induce purchases of the Aero Systems securities by the customers of Sebag and FSSC and thereby generate trading volume and cause a corresponding increase in the price of these securities. These defendants failed to disclose to investors their

domination and control of the market for Aero Systems stock and their scheme to manipulate its price.

90. Defendants Lugo and Garrity also began, in the summer of 1980, to purchase large positions of Aero Systems stock for the proprietary accounts of Sebag and FSSC with the intent to dominate and control the market for that stock and thereby artificially raise its price. Lugo made such purchases from various of the participants in the racketeering enterprise, including but not limited to, purchases from Nettie Vigman and Diamond.

91. The above-alleged conduct by these defendants materially contributed to the net capital deficiencies of Sebag and FSSC by permitting defendants Lugo and Garrity to acquire large positions of Aero Systems common at inflated and manipulated prices and to pay out proceeds to defendants and others who sold the securities, directly or indirectly, through or to Sebag and FSSC. The defendants and others thereby extracted substantial capital from FSSC and Sebag and further contributed to their respective net capital deficits, depletion of the funds of customer property and the ultimate demise of Sebag and FSSC.

92. The conduct alleged herein constituted a fraud on the marketplace for Aero Systems common whereby the investing public, and the customers and creditors of Sebag and FSSC were unable to obtain true and accurate information concerning the legitimate demand for, supply of and resulting price of Aero Systems common.

93. As a result of the manipulation, the market price of Aero Systems stock continued to rise from the September, 1980 bid and ask prices to $9 3/8 bid, $9 1/2 ask in

early December, 1980. Thereafter, Aero Systems stock split five shares for four in January, 1981. The split stock reached a high of $7 5/8 bid, $7 7/8 ask on May 8, 1981, the equivalent of over $9 1/2 bid on a pre-stock-split basis. The bid price remained at $6 or more per share through June 29, 1981. Upon the demise of the manipulative scheme herein alleged, the price of the stock declined, dropping to $5 1/4 bid, $5 3/8 ask on July 27, 1981.

94. For the fiscal year ended February 28, 1979, Aero Systems had reported net income of $1,300,585, which included the gain of $442,346 from the sale of Springwater Manufacturing as alleged above. After retroactively reflecting the 5-for-4 stock split of January, 1981, the market price per share at bid, as of February 28, 1979, was $1.90 and net income per share was $0.21. The total market price at bid of Aero Systems stock outstanding was 3.27 times the net worth of the company which had a price (bid) earnings ratio of 9 to 1.

95. Net income for Aero Systems declined for the fiscal year ended February 29, 1980. After retroactively reflecting the January, 1981 stock split, net income per share dropped to $0.134 for fiscal year 1980, but the market price of the stock increased. The total market price for Aero Systems stock outstanding, as of February 29, 1980, increased to 4.12 times the net worth of Aero Systems, while the price to earnings ratio increased to 22.4 to 1.

96. For fiscal year 1981, ending February 28, 1981, net income continued to decline, as did net income per share which fell to $0.075. In spite of a price to earnings ratio of over 150 to 1, the continued manipulation of the price of Aero Systems common resulted in the total market price for

Aero Systems' outstanding stock increasing to in excess of 5.7 times the net worth of Aero Systems.

97. Between April, 1980 and July, 1981, defendants Nettie Vigman, Diamond, and Holmes, among others, with knowledge of the fraud perpetrated on the market by Aero Systems, Lugo and Garrity as herein alleged, sold large positions of Aero Systems stock at artificially inflated prices. Such sales include, but are not limited to:

(a) Diamond's sale of 25,000 shares of Aero Systems at $4 per share on or about September 18, 1980, for proceeds of $100,000; 25,000 shares at $4 1/4 per share on or about September 19, 1980, for proceeds of $106,250; and plaintiffs are informed and believe, and thereon allege, that defendant Diamond sold 7,908 shares of Aero Systems on or about February 19, 1981, for proceeds of $41,517;

(b) Nettie Vigman's sales of Aero Systems stock;

Quantity	Approximate Date	Price	Proceeds
10,000	September 4, 1980	$3 5/8	$ 36,250
10,000	September 4, 1980	$3 1/2	$ 35,000
35,000	April 2, 1981	$5 3/4	$ 201,250
7,500	April 6, 1981	$6	$ 45,000
10,000	April 7, 1981	$5 7/8	$ 58,750
12,500	April 7, 1981	$5 7/8	$ 73,437.50
25,000	April 13, 1981	$6 5/8	$ 165,625
35,000	April 13, 1981	$6 1/2	$ 227,500
10,000	April 14, 1981	$6 5/8	$ 66,250
5,000	April 23, 1981	$6 5/8	$ 33,125
10,000	May 14, 1981	$6 3/4	$ 67,500
15,000	May 14, 1981	$6 1/4	$ 93,750
10,000	May 14, 1981	$7	$ 70,000
6,565	May 14, 1981	$7 1/8	$ 46,775.63
Total 201,565 shares			$1,220,213.13

(c) Plaintiffs are informed and believe, and thereon allege, that defendant Holmes sold 50,000 shares of Aero Systems stock at $8 per share on or about November 12, 1980, for proceeds of $400,000; and sold 25,000 shares at $5 per share on or about July 24, 1981, for proceeds of $125,000; and

(d) Sales by Speyer, the son-in-law of defendants Vigman and Nettie Vigman, of 50,000 shares of Aero Systems at $4¾ per share on or about September 23, 1980, for proceeds of $237,500; 45,698 shares of Aero Systems at $8½ per share on or about January 2, 1981, for proceeds of $388,433; and 11,227 shares of Aero Systems at $8 per share on or about January 9, 1981, for proceeds of $89,816. Plaintiffs are informed and believe, and thereon allege, that these transactions constituted all of the Aero Systems stock received by Speyer as a result of the acquisition of DCS Financial by Aero Systems, as alleged above.

98. As a direct and proximate result of the conduct alleged herein, plaintiffs have been damaged in a total amount not yet ascertained but exceeding $15,000,000. Plaintiffs will seek leave to amend this First Amended Complaint when their exact damages have been determined.

* * *

SIXTEENTH CLAIM FOR RELIEF BY PLAINTIFFS AGAINST DEFENDANTS AERO SYSTEMS; AEROSONIC; CREDITBANK; DASH; BUNNINGTON; HOLMES; FRANK; DAVID S. GOLDMAN; BLUMENTHAL; JAY DASH; SALA; HABER; PHILLIP DASH; DIAMOND; VIGMAN; McNEIL

[Aiding and Abetting Violations of 17 C.F.R. § 240.10b-5; 15 U.S.C. § 78j(b)]

239. Plaintiffs incorporate by reference paragraphs 1 through 238 of this First Amended Complaint.

240. At all times relevant herein and in particular during the period that Lugo, Garrity and Shaw were engaged in the fraudulent, manipulative conduct herein alleged:

(a) Defendants Holmes and Aero Systems were aware of the true financial condition of Aero Systems;

(b) Defendants Frank, David S. Goldman and Aerosonic were aware of the true financial condition of Aerosonic;

(c) Defendants Haber, Sala and Creditbank were aware of the true financial condition of Creditbank;

(d) Defendants Blumenthal, Jay Dash, Phillip Dash and Dash were aware of the true financial condition of Dash;

(e) Defendants Diamond, Vigman, McNeil and Bunnington were aware of the true financial condition of Bunnington; and

(f) Each of the above-captioned defendants knew that FSSC and Sebag traded substantial positions in the securities of their respective corporations: (1) for the proprietary accounts of

FSSC and Sebag; and (2) for the customer accounts of FSSC and Sebag.

241. Plaintiffs are informed and believe, and therefore allege, that the above-captioned defendants knew or recklessly disregarded information available to them that indicated that the price of their respective corporation's common stock bore no reasonable relationship to its true financial condition.

242. The above-captioned defendants substantially assisted Lugo, Garrity and Shaw to fraudulently manipulate the prices of the securities of the above-captioned corporations by:

(a) Issuing or causing to be issued false and misleading statements contained in press releases, letters, advertising, public statements and other media concerning their respective corporate financial conditions, new products and acquisitions as previously alleged herein to the general public, to their shareholders and to defendants Lugo, Garrity and Shaw;

(b) Consummating several mergers and acquisitions during the period that Lugo, Garrity and Shaw engaged in their fraudulent manipulations; and

(c) Defendants Aerosonic, Dash and Bunnington made various private placements of their securities during the period that Lugo, Garrity and Shaw engaged in their fraudulent manipulations.

All of the above-referenced conduct was done with the intent to induce public confidence in purchases and OTC market activity in the respective securities of the above-captioned corporate defendants.

243. An integral part of the various manipulations herein alleged was the creation of public interest in, and purchases of, the securities of the above-captioned corporations through the public dissemination of misleading information regarding their financial status, purported products, mergers and acquisitions and private placements.

244. Plaintiffs are informed and believe, and therefore allege, that the above-captioned individual defendants had actual knowledge of defendants Lugo, Garrity and Shaw's fraudulent manipulation of the price for the common stock of the corporations of which those individual defendants were officers and/or directors and further had actual knowledge of their respective roles in those manipulations. Plaintiffs are informed and believe, and therefore allege, that the above-captioned corporate defendants, through their officers, directors or agents, also had actual knowledge of those manipulations and the respective roles of those corporate defendants therein.

245. As a direct and proximate result of the conduct alleged herein, plaintiffs have been damaged in a total amount not yet ascertained, but exceeding $15,000,000. Plaintiffs will seek leave to amend this First Amended Complaint when their exact damages have been determined.

SEVENTEENTH CLAIM FOR RELIEF BY PLAINTIFFS AGAINST THE FOLLOWING DEFENDANTS: DIAMOND; EISEMAN; VIGMAN; NETTIE VIGMAN; LUGO; GARRITY; FRANKIE MAE GARRITY; HOLMES; AERO SYSTEMS; BLUMENTHAL; PHILLIP DASH; JAY DASH; DASH; HABER; SALA; CALONGE; CREDITBANK; IBEBAFIN, S.A.; KEOPS, S.A.; McNEIL; BUNNINGTON; AEROSONIC; DAVID S. GOLDMAN; FRANK; CIPPARONE; SHAW; TALINGO; AND TULA; COLLECTIVELY REFERRED TO IN THIS CLAIM AS THE "RICO DEFENDANTS."

(RICO Violations)

[18 U.S.C. § 1961, et seq.]

246. Plaintiffs incorporate herein by reference paragraphs 1 through 245 of this First Amended Complaint.

247. From as early as 1964 and continuing to the date hereof, the RICO Defendants, and each of them: (1) have received income from a pattern of racketeering activity and have used and invested such income to acquire interests in, establish and operate an enterprise engaged in and affecting interstate commerce (the "racketeering enterprises"); (2) have, through a pattern of racketeering activity, acquired and maintained interest in and control of the racketeering enterprise; (3) have, through their employment by or association with the racketeering enterprise, conducted and participated in the conduct of the affairs of the racketeering enterprise; and (4) have conspired among themselves to accomplish the above as herein alleged. Between no later than January, 1979 and continuing through at least July, 1981 the RICO defendants continued to carry on the racketeering enterprise through FSSC and Sebag. This conduct gave the RICO

defendants two additional access points to the OTC market that facilitated the pattern of racketeering activity herein alleged.

248. Plaintiffs are informed and believe and thereon allege that, in the course of the above-described racketeering activity, the RICO Defendants, and each of them committed fraud in the sale of securities, violated Sections 1341 and 1343 of Title 18, United States Code (mail and wire fraud, respectively) and committed offenses involving fraud connected with a case under Title 11, United States Code. In the course of the pattern of racketeering activity alleged herein, the RICO Defendants, and each of them committed at least two acts of racketeering activity, as defined in 18 U.S.C. § 1961(1), within ten years of each other.

249. The Aerosonic manipulation (First Claim For Relief), the Aero Systems manipulation (Second Claim For Relief), the Bunnington manipulation (Third Claim For Relief), the Creditbank manipulation (Fourth Claim For Relief), the Dash manipulation (Fifth Claim For Relief), and the Osrow Products manipulation (Sixth Claim For Relief) were in fact a series of interdependent, consciously parallel courses of conduct engaged in pursuant to a tacit understanding between the RICO defendants and constituted a conspiracy by the RICO defendants to do the acts alleged herein.

250. The activity alleged herein permitted the RICO Defendants, and each of them, to maintain an anticompetitive and favored position in the national OTC market vis-a-vis the general public, and resulted in extensive

financial loss to SIPC and the securities account customers of FSSC, and Sebag. Such racketeering activity also resulted in anti-competitive control and domination by the RICO Defendants over Sebag and FSSC, resulting in financial destruction and the liquidation of Sebag and FSSC and damages to SIPC.

251. The conduct alleged in paragraphs 1 through 250, inclusive, constitutes violations of 18 U.S.C. § 1962.

252. Pursuant to 18 U.S.C. 1964(c), plaintiffs are entitled to treble the damages proved at trial. Further, plaintiffs are entitled to such injunctive and equitable relief provided for under 18 U.S.C. § 1964(a), as the Court may deem just and proper.

253. Pursuant to 18 U.S.C. § 1964(c), plaintiffs are entitled to recover their costs of suit and reasonable attorneys' fees.

254. As a direct and proximate result of the conduct alleged herein, plaintiffs have been damaged in a total amount not yet ascertained but exceeding $15,000,000. Plaintiffs will seek leave to amend this First Amended Complaint when their exact damages have been determined.

* * *

WHEREFORE, plaintiffs pray for relief as follows:

A. By Plaintiff SIPC:

1. For damages in the amount of all advances to the respective trustees for payment of net equity claims paid

to customers of FSSC and Sebag since commencement of their liquidation proceedings according to proof;

2. For damages to that portion of the fund of customer property to which SIPC is subordinated to the claims of customers of FSSC and Sebag according to proof;

3. For all advances for costs and expenses of the administration of the liquidation proceedings of Sebag and FSSC according to proof;

4. For treble the damages referenced in paragraphs 1, 2 and 3 of this Prayer;

5. For punitive damages in the amount of $100,000,000; and

6. For reasonable attorneys' fees and costs.

B. By Plaintiffs Bell and Britton:

7. For damages caused to that portion of the debtors' estates available to satisfy creditor claims, subordinated lenders and shareholders according to proof;

8. For destruction of the businesses of Sebag, FSSC and for loss of goodwill;

9. For all costs and expenses of their administration of the estates of Sebag and FSSC;

10. Treble the damages referenced in paragraphs 7, 8 and 9 of this Prayer;

11. Punitive damages in the amount of $100,000,000; and

12. For reasonable attorneys' fees and costs.

C. By All Plaintiffs:

13. For such equitable and injunctive relief as the Court deems proper.

14. For such other and further relief as the Court deems proper.

Dated: September 27, 1984.

JONES, BELL, SIMPSON & ABBOTT
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DEMAND FOR JURY TRIAL

Pursuant to Fed.R.Civ.P. 38 (b), plaintiffs respectfully request trial by jury.

Dated: September 27, 1984.

JONES, BELL, SIMPSON & ABBOTT
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DECLARATION OF SERVICE BY MAIL

[U. S. District Court, Central District, Local Rule 5(b)(3)]

SHARON L. STEVENSON, the undersigned, hereby declares

Declarant is a citizen of the United States and is employed by the law firm of Sheppard, Mullin, Richter & Hampton, 48th Floor, 333 South Hope Street, Los Angeles, California 90071. Declarant is over the age of 18 years and not a party to the within action. On September 27, 1984, at the direction of Stephen C. Taylor of said firm, and a member of the Bar of the United States District Court for the Central District of California, I served the within FIRST AMENDED COMPLAINT FOR DAMAGES: A) FOR VIOLATION OF THE SECURITIES EXCHANGE ACT OF 1934 [15 U.S.C. §§ 78a, *et seq.*]; B) FOR VIOLATION OF THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT [18 U.S.C. §§ 1961, *et seq.*]; C) BREACH OF FIDUCIARY DUTY; and D) FRAUD. DEMAND FOR JURY TRIAL on the attorney(s) of record for the defendants in this matter by mailing, with postage thereon fully prepaid, in a mail facility regularly maintained by the United States Postal Service, a true copy thereof to said attorney(s) at their known address, to wit:

PLEASE SEE ATTACHED LIST

I declare under penalty of perjury that the foregoing [sic] is true and correct.

Executed at Los Angeles, California, on the 27th day of September, 1984.

/s/ Sharon L. Stevenson
Declarant

September 27, 1984

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al., **PLAINTIFF(S)** vs. SEYMOUR VIGMAN (please see attached) **DEFENDANT(S)**	)	CASE NUMBER CV-83-4742-AWT (Tx) SUMMONS ON FIRST AMENDED COMPLAINT

TO THE ABOVE-NAMED DEFENDANT(S), You are hereby summoned and required to serve upon

JONES, BELL, SIMPSON and & ABBOTT
Attorneys for Plaintiffs
Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated, and John L. Britton, Trustee for the Liquidation of First State Securities Corporation

SHEPPARD, MULLIN, RICHTER & HAMPTON
Attorneys for Plaintiff Securities Investor Protection Corporation

Plaintiff's attorney, whose address is:

Suite 580
800 Wilshire Boulevard
Los Angeles, California 90017

48th Floor
333 South Hope Street
Los Angeles, California 90071

an answer to the complaint which is herewith served upon you within 20 days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

DATE: SEP 2, 1984

LEONARD A. BROSNAN, CLERK
By Yolanda Duron
Deputy Clerk
(SEAL OF THE COURT)

SUMMONS

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Plaintiffs,

vs.

SEYMOUR VIGMAN, AERO SYSTEMS, INC., AEROSONIC CORPORATION, CREDITBANK, INC., DASH INDUSTRIES, INC., HABERICO, INC., HABERS, INC., HABERS, INC., [sic] DEFINED BENEFIT PENSION TRUST, IBEBAFIN, S.A., KEOPS, S.A., MAGNETIC TECHNOLOGIES CORPORATION, TALINGO CORPORATION, TULA CORPORATION, MARTIN

BLUMENTHAL, JOSE LUIS)
CALONGE, aka JOSE LUIS)
CALONGE RIVAS, DOLORES)
OWENS CIPPARONE, aka DEE)
CIPPARONE, JAY DASH, PHILLIP)
DASH, ISADORE DIAMOND,)
ELLIOT I. EISEMAN, HERBERT J.)
FRANK, FRANKIE MAE GARRITY)
RODGER W. GARRITY, DAVID S.)
GOLDMAN, JACK A. HABER,)
ROBERT G. HOLMES, JR., JOSEPH)
A. LUGO, JR., ROBERT J.)
MANSELL, GORDON H. McNEIL,)
EDWARD P. PRESCOTT, JOSE)
CAMPRUBI SALA, VELMA SHAW)
aka VELMA SHAW MYERS,)
NETTIE VIGMAN and)
LAWRENCE WEST, aka LARRY)
WEST,)
Defendants.)

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* * *

BUCHALTER, NEMER, FIELDS,
CHRYSTIE & YOUNGER
A Professional Corporation
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Attorneys for Defendant
Robert G. Holmes, Jr.

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

(FILED APR 3 - 1985)

SECURITIES INVESTOR PROTECTION CORPORATION, et al., Plaintiffs, vs. SEYMOUR VIGMAN, et al., Defendants.	CASE NO. 83-4742-AWT (Tx) ANSWER OF DEFENDANT ROBERT G. HOLMES, JR. TO FIRST AMENDED COMPLAINT FOR DAMAGES

Defendant Robert G. Holmes, Jr. ("Holmes") alleges as and as for his Answer to the First Amended Complaint for Damages (hereinafter the "Complaint") as follows:

1. Defendant Holmes denies that the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961, *et seq* ("RICO") is applicable to this action, and accordingly, defendant Holmes denies that this Court has jurisdiction over the subject matter of this action under

RICO as alleged in Paragraph 1 of the Complaint. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the remainder of the allegations contained in Paragraph 1 of the Complaint.

2. Defendant Holmes denies the material allegations contained in Paragraph 2 of the Complaint and expressly denies that venue of this action lies properly in the Central District of California.

3. Defendant Holmes admits the allegations contained in Paragraph 3(A) of the Complaint. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations set forth with respect to Joseph Sebag, Incorporated ("Sebag") in Paragraph 3(B) of the Complaint, except that defendant Holmes admits that at various times during the preceding five years, Sebag appeared to trade on behalf of certain of its customers the securities of defendant Aero Systems, Inc. (hereinafter "Aero Systems") and defendant Holmes admits that defendant Aero Systems was engaged in interstate commerce during the past five years. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 3(B) of the Complaint with respect to plaintiff Eugene W. Bell ("Bell"). Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained at Paragraph 3(C) of the Complaint with respect to plaintiff John L. Britain ("Britain") except that defendant Holmes admits that at certain times during the preceding five years First State Securities Corporation

("FSSC") appeared to trade the securities of Aero Systems for certain of its customers.

4. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 4 of the Complaint.

5. Defendant Holmes admits that the persons identified in Paragraph 5 of the Complaint appear to have been made defendants in this action. In all other respects, defendant Holmes denies the allegations of Paragraph 5 of the Complaint pertaining to defendants Holmes and Aero Systems and denies knowledge or information sufficient to form a belief as to the truth of these allegations insofar as they pertain to other named defendants.

6. Defendant Holmes denies the allegations contained in Paragraph 6 of the Complaint as applied to defendants Holmes and Aero Systems and, without limiting the generality of the foregoing, expressly denies that defendant Holmes engaged in any conduct to manipulate and artificially inflate the price of any security. With respect to all other defendants, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 6 of the Complaint.

7. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 7 of the Complaint except that defendant Holmes denies that there was any fraudulent manipulation of the common stock of Aero Systems with respect to which defendants Holmes or Aero Systems engaged in any wrongful conduct.

8. Defendant Holmes denies the allegations contained in Paragraph 8 of the Complaint as applied to defendant Holmes and denies knowledge or information sufficient to form a belief concerning the truth of such allegations as applied to other defendants.

9. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 9 of the Complaint.

10. Defendant Holmes denies the allegations of Paragraph 10 of the Complaint as applied to defendant Holmes and denies knowledge or information sufficient to form a belief concerning the truth of such allegations as applied to other defendants except that defendant Holmes admits that by means of a prospectus dated March 2, 1967, Aero Systems publicly offered 100,000 shares of its common stock in an offering with respect to which J.C. Roberts was an underwriter and otherwise upon terms and conditions more particularly described in such prospectus, the entirety of which is hereby incorporated by reference.

11. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 11 through 18, inclusive of the Complaint.

12. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations pertaining to exercise of control by Seymour Vigman ("Vigman") over corporations and issuers of securities referred to in Paragraph 19 of the Complaint except that defendant Holmes denies that Vigman exercised control over defendant Aero Systems.

Defendant Holmes admits that defendant Vigman provided certain financial advice to defendant Aero Systems and in all other respects, defendant Holmes denies the allegations contained in Paragraph 19 of the Complaint.

13. Defendant Holmes denies the allegations contained in Paragraph 20 of the Complaint as applied to defendant Holmes and denies knowledge or information sufficient to form a belief as to the truth of such allegations insofar as they pertain to other defendants.

14. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 21 through 25, inclusive of the Complaint.

15. Defendant Holmes admits the allegations contained in Paragraph 26 of the Complaint.

16. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 27 of the Complaint.

17. Defendant Holmes admits the allegations contained in Paragraph 28 of the Complaint.

18. Defendant Holmes admits that on or about July 1976, a subsidiary of defendant Aero Systems acquired DCS Financial which was merged into Aero Systems Avionics, and in all other respects, defendant Holmes denies the allegations contained in Paragraph 29 of the Complaint and refers to and hereby incorporates by reference the full text of the acquisition agreement and publicly filed reports and disclosures of such agreement for an accurate description of the transaction.

19. Defendant Holmes denies that any purpose, in whole or in part, for the merger of DCS Financial into a subsidiary of Aero Systems was in any manner unlawful or improper, and in all respects defendant Holmes denies the allegations contained in Paragraph 30 of the Complaint.

20. Defendant Holmes denies that defendant Isadore Diamond ("Diamond") became an officer or director of Aero Systems in order to "assist" defendant Holmes; defendant Holmes admits that the individuals acquired the number of Aero Systems shares set forth in Paragraph 31, and in all other respects, defendant Holmes denies the allegations contained in Paragraph 31 of the Complaint.

21. Defendant Holmes admits the allegations contained in Paragraph 32 of the Complaint.

22. Defendant Holmes denies the allegations contained in Paragraph 33 of the Complaint and alleges that defendant Aero Systems sold the assets of Springwater Manufacturing to a subsidiary of defendant Bunnington.

23. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations set forth in Paragraph 34 of the Complaint.

24. Defendant Holmes denies the allegations of Paragraph 35 as applied to defendants Holmes and Aero Systems, and as applied to other defendants, denies knowledge or information sufficient to form a belief concerning the truth of such allegations.

25. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of

the allegations contained in Paragraphs 36 through 55, inclusive of the Complaint.

26. In answer to Paragraph 56 of the Complaint, Defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 55 of this Answer with the same force and effect as if set forth at full length herein.

27. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 57 through 74, inclusive of the Complaint.

28. In answer to Paragraph 75 of the Complaint, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 74 of this Answer with the same force and effect as if set forth at full length herein.

29. Defendant Holmes admits that at certain times he was an officer, controlling person (as defined) and principal shareholder and director of defendant Aero Systems, that at certain times defendant Aero Systems transacted its affairs within the Central District of California on a limited basis, and that defendant Holmes owed a duty to shareholders and purchasers and sellers of the securities of Aero Systems and the investing public to refrain from engaging in unlawful conduct, which duty defendant Holmes alleges was fully satisfied. Defendant Holmes denies knowledge or information sufficient to form a belief whether at "all times relevant" defendant Diamond was an officer, director and controlling person of defendant Bunnington. In all other respects, defendant

Holmes denies the allegations contained in Paragraph 76 of the Complaint.

30. Defendant Holmes admits that on or about July 1976 defendant Aero Systems acquired Springwater Manufacturing and that a wholly owned subsidiary of defendant Bunnington subsequently acquired Springwater Manufacturing. In all other respects, defendant Holmes refers to and hereby incorporates by reference the documents pertaining to such transaction for an accurate description of such transactions. In all other respects, defendant Holmes denies the allegations contained in Paragraph 77 of the Complaint.

31. Defendant Holmes admits the allegations contained in Paragraph 78 of the Complaint.

32. Defendant Holmes admits that for the fiscal year ended February 28, 1979, defendant Aero Systems reported a gain of $442,346 including income tax benefits in connection with the disposition of Springwater Manufacturing. In all other respects, defendant Holmes denies the allegations contained in Paragraph 79 of the Complaint.

33. Defendant Holmes admits the allegations contained in Paragraph 80 of the Complaint.

34. Defendant Holmes denies the allegations contained in Paragraph 81 of the Complaint.

35. Defendant Holmes denies the allegations contained in Paragraph 82 of the Complaint to the extent such allegations apply to defendants Holmes and Aero Systems, and defendant Holmes denies knowledge or information sufficient to form a belief as to the truth of

such allegations to the extent they pertain to other defendants.

36. Defendant Holmes admits that Aero Systems publicly announced during or about April 1980 that it had acquired from Colt Electronics Co., Inc. ("Colt Electronics") a right to exclusively market a computerized fuel management system known as the CD-3000 Fuel Management Computer ("CD-3000"). Defendant Holmes admits that the press releases and shareholder letters identified in subparagraphs (A)-(H) of Paragraph 83 of the Complaint were published, and defendant Holmes refers to and hereby incorporates by reference the complete text of such statements for an accurate description of their contents. Defendant Holmes denies that any of the statements made by defendants Holmes or Aero Systems quoted in Paragraph 83 were misleading or created a misleading impression that sales of the CD-3000 had already been made, and in all other respects defendant Holmes denies the allegations contained in Paragraph 83 of the Complaint.

37. Defendant Holmes denies the allegations contained in Paragraph 84 of the Complaint. Without limiting the generality of the foregoing, defendant Holmes alleges:

(a) the quoted statements did not indicate that any sales of the CD-3000 had been made, and it was not false or misleading to present a reasonable prospect of significant sales in the future at the time at which the statements were made; and

(b) the statements did not vastly overstate, or overstate to any material degree, the potential market for the product; and

(c) the statements never indicated that Aero Systems "would reap a bonanza" as alleged in the Complaint, and such language constitutes itself a false and misleading characterization of the statements made; and

(d) there was a reasonable factual basis for the projected ten percent fuel savings; and

(e) and (f) Aero Systems did not fail to make any disclosure which it was required to make with respect to the terms and conditions of the acquisition of the CD-3000 from Colt Electronics.

38. Defendant Holmes denies the allegations contained in Paragraph 85 of the Complaint and, without limiting the generality of the foregoing, denies that defendant Holmes caused any false or recklessly misleading material misrepresentation to be made regarding Aero Systems sales and projected earnings for fiscal year 1981 and sales and earnings of the CD-3000. Without limiting the generality of the foregoing, defendant Holmes alleges as follows:

(a) the statements made in Moore & Schley, Cameron & Co. Research Department Publication were the responsibility of that entity and not of defendant Holmes;

(b) the statements made in Wheat First Securities Technology Group Publication were the responsibility of that entity and not of defendant Holmes; and

(c) the statements made in an undated Porter, Le Vay & Rose, Inc. Information Report were the responsibility of that entity and not of defendant Holmes;

(d) the statements made in the Alan J. Wax column of the New York Post on October 13, 1980 were the responsibility of that individual and publication and not of defendant Holmes; and

(e) the statements made in the column of Dick Davis in the Miami Herald were the responsibility of that entity and not of defendant Holmes.

39. Defendant Holmes denies the material allegations contained in Paragraph 86 of the Complaint. Without limiting the generality of the foregoing, defendant Holmes alleges as follows:

(a) the interest of potential buyers in the CD-3000 was not misstated, and the prospective market for the CD-3000 at the time was not "very limited";

(b) there were reasonable bases for the projected sales and future earnings to the extent that the projections were made by defendant Holmes, if any; and

(c) there was a reasonable factual basis for the estimated ten percent fuel savings that could purportedly be achieved by users of the CD-3000; and

(d) the statement made that Aero Systems had sold 250 units of the CD-3000 was not made by defendant Holmes.

40. Defendant Holmes denies that the statements made pertaining to completed sales of the CD-3000 were made by or at the direction of defendants Aero Systems

or Holmes, and in all other material respects, defendant Holmes denies the allegations contained in Paragraph 87 of the Complaint.

41. Defendant Holmes admits that the price of Aero Systems stock for 100 shares was quoted in the "pink sheets" by at least one market maker at $2 5/8 bid and $2 3/4 asked during August 1980 and was quoted at a price of $7 bid and $7 1/8 asked in September 1980. In all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 88 of the Complaint.

42. Defendant Holmes denies that the matters alleged, insofar as the same pertain to defendant Holmes, constituted misstatements or misrepresentations or reflected reckless disregard of the truth, and in all other respects, defendant Holmes denies the material allegations contained in Paragraph 89 of the Complaint.

43. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 90 of the Complaint.

44. Defendant Holmes denies the allegations of Paragraph 91 of the Complaint insofar as the same pertain to defendants Holmes and Aero Systems, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of such allegations as the same may apply to other defendants.

45. Defendant Holmes denies the allegations contained in Paragraph 92 of the Complaint.

46. Defendant Holmes admits that at least one securities broker quoted in a "pink sheet" a price of $7 5/8 bid and $7 7/8 asked on May 8, 1981, bid and ask prices of $9 3/8 bid and $ 9 1/2 asked in early December 1980, and $5 1/4 bid and $5 3/8 asked on July 27, 1981 for 100 share lots of shares of Aero Systems. In all other respects, defendant Holmes denies the material allegations contained in Paragraph 93 of the Complaint.

47. Defendant Holmes admits that for the fiscal year ended February 28, 1979, Aero Systems reported net income of $1,300,585. Defendant Holmes also admits that at least one broker quoted a bid for Aero Systems common stock as of February 28, 1979 of approximately $1.90. In all other respects, defendant Holmes denies the material allegations contained in Paragraph 94 of the Complaint.

48. Defendant Holmes admits that Aero Systems reported an income of $0.134 per share for the fiscal year 1980. In all other respects, defendant Holmes denies the material allegations contained in Paragraph 95 of the Complaint.

49. Defendant Holmes denies the material allegations contained in Paragraph 96 of the Complaint.

50. Defendant Holmes denies that he was aware of any fraud and that he sold any shares of Aero Systems with knowledge of any fraud. Without limiting the generality of the foregoing, defendant Holmes denies knowledge or information sufficient to form a belief concerning

the truth of the allegations contained in subparagraphs (A), (B) and (D) of Paragraph 97 of the Complaint. With respect to subparagraph (C) of the Complaint, defendant Holmes admits that defendant Holmes sold approximately 50,000 shares of common stock of Aero Systems at $8.00 per share on or about November 12, 1980 and 25,000 shares of common stock of Aero Systems at $5.00 per share on or about July 24, 1981.

51. Defendant Holmes denies the allegations contained in Paragraph 98 of the Complaint.

52. In answer to Paragraph 99, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 98 of this Answer with the same force and effect as if set forth at full length herein.

53. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 100 through 101, inclusive of the Complaint.

54. Defendant Holmes admits that at certain times he owned securities of Bunnington Corporation. In all other respects, defendant Holmes denies the allegations contained in Paragraph 102 of the Complaint.

55. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 103 and 104, inclusive of the Complaint.

56. Defendant Holmes admits that DCS Financial merged into and with a subsidiary of Aero Systems, that Aero Systems disposed of the assets of Springwater Manufacturing, and in all other respects, defendant Holmes

denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 105 of the Complaint.

57. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 106 of the Complaint.

58. Defendant Holmes expressly denies that any action of defendant Holmes or of defendant Aero Systems facilitated wrongful concealment by any other person or entity and in all other respects, defendant Holmes generally denies the allegations contained in Paragraph 107 of the Complaint.

59. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 108 through 119, inclusive of the Complaint.

60. Defendant Holmes admits that for the fiscal year ended July 31, 1979, Bunnington reported net sales of $9,749,314 and net income of $404,039. In all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 120 of the Complaint.

61. Defendant Holmes admits that for the fiscal year ended July 31, 1980, Bunnington reported a net loss of $708,269. In all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 121 of the Complaint.

62. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 122 through 124, inclusive of the Complaint.

63. Defendant Holmes denies the allegations of Paragraph 125 insofar as the same may pertain to defendants Holmes and Aero Systems, and as to all other defendants, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of such allegations.

64. In answer to Paragraph 126, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 125 of this Answer with the same force and effect as if set forth at full length herein.

65. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 127 through 145, inclusive of the Complaint.

66. In answer to Paragraph 146, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 145 of this Answer with the same force and effect as if set forth at full length herein.

67. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 147 through 171, inclusive of the Complaint.

68. In answer to Paragraph 172, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 171 of this Answer with the same force and effect as if set forth at full length herein.

69. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 173 through 180, inclusive of the Complaint.

70. In answer to Paragraph 181, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 180 of this Answer with the same force and effect as if set forth at full length herein.

71. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 182 through 185, inclusive of the Complaint.

72. In answer to Paragraph 186, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 185 of this Answer with the same force and effect as if set forth at full length herein.

73. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 187 through 189, inclusive of the Complaint.

74. In answer to Paragraph 190, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 189 of this Answer with the same force and effect as if set forth at full length herein.

75. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 191 through 195, inclusive of the Complaint.

76. In answer to Paragraph 196, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 195 of this Answer with the same force and effect as if set forth at full length herein.

77. Defendant Holmes denies any fraudulent manipulation of the price of stock of Aero Systems, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 197 of the Complaint.

78. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 198 of the Complaint.

79. In answer to Paragraph 199, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 198 of this Answer with the same force and effect as if set forth at full length herein.

80. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 200 through 206, inclusive of the Complaint.

81. In answer to Paragraph 207, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 206 of this Answer with the same force and effect as if set forth at full length herein.

82. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 208 through 212, inclusive of the Complaint.

83. In answer to Paragraph 213, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 212 of this Answer with the same force and effect as if set forth at full length herein.

84. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 214 of the Complaint.

85. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 215 through 221, inclusive of the Complaint.

86. In answer to Paragraph 222, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 221 of this Answer with the same force and effect as if set forth at full length herein.

87. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 223 through 231, inclusive of the Complaint.

88. In answer to Paragraph 232, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 231 of this Answer with the same force and effect as if set forth at full length herein.

89. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 233 through 238, inclusive of the Complaint.

90. In answer to Paragraph 239, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 238 of this Answer with the same force and effect as if set forth at full length herein.

91. Defendant Holmes admits that he was aware of the true financial condition of Aero Systems, alleges as a matter of presumption that Aero Systems was aware of the true financial condition of Aero Systems, and in all other respects denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 240 of the Complaint.

92. Defendant Holmes denies that defendants Holmes or Aero Systems knew or recklessly disregarded any information of the type described in Paragraph 241 of the Complaint and alleges that the market price of publicly traded securities is determined by various conditions and events which do not necessarily bear any particular relationship to the reported financial condition of an issuer, as of or at a particular period of time, and in all other respects, defendant Holmes denies the allegations contained in Paragraph 241 of the Complaint.

93. Defendant Holmes denies that defendant Holmes, or to his knowledge, defendant Aero Systems, provided any of the assistance described in Paragraph 242 of the Complaint, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 242 of the Complaint.

94. Defendant Holmes denies the allegations contained in Paragraphs 243 through 245, inclusive of the Complaint as the same pertain to defendants Holmes and

Aero Systems, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of such allegations.

95. In answer to Paragraph 246, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 245 of this Answer with the same force and effect as if set forth at full length herein.

96. Defendant Holmes denies the allegations contained in Paragraphs 247 and 248, inclusive of the Complaint as the same pertain to defendants Holmes and Aero Systems and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of such allegations.

97. Defendant Holmes denies the existence of an alleged "Aero Systems manipulation" as purportedly described in the Second Claim for Relief and incorporates by reference the Answer of defendant Holmes to each allegation of the Second Claim For Relief, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 249 of the Complaint.

98. Defendant Holmes denies the allegations contained in Paragraphs 250 through 254, inclusive of the Complaint as the same pertain to defendants Holmes and Aero Systems, and as to all other defendants, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of such allegations.

99. Defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 254 of this

Answer with the same force and effect as if set forth at full length herein.

100. Defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraphs 256 through 258, inclusive of the Complaint.

101. In answer to Paragraph 259, defendant Holmes repeats and realleges the allegations contained in Paragraphs 1 through 258 of this Answer with the same force and effect as if set forth at full length herein.

102. Defendant Holmes denies that defendants Holmes or Aero Systems were aware of any false representations of the nature described in Paragraph 260 of the Complaint, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 260 of the Complaint.

103. Defendant Holmes denies making any false representations as alleged in Paragraph 261 of the Complaint, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of allegations contained in Paragraph 261 of the Complaint.

104. Defendant Holmes denies the allegations contained in Paragraph 262 of the Complaint as the same pertain to defendants Holmes and Aero Systems, and in all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of such allegations.

105. Defendant Holmes denies the allegations contained in Paragraph 263 of the Complaint to the extent the same may apply to defendants Holmes and Aero Systems. In all other respects, defendant Holmes denies knowledge or information sufficient to form a belief concerning the truth of the allegations contained in Paragraph 263 of the Complaint.

FIRST AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Failure to State a Claim)

106. The Complaint fails to state any claim upon which relief can be granted.

SECOND AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Statute of Limitations)

107. The Complaint and purported claims for relief are barred in whole or in part by California Code of Civil Procedure Section 338(4).

108. The Complaint and purported claims for relief are barred in whole or in part by California Code of Civil Procedure Section 343.

109. The Complaint and purported claims for relief are barred in whole or in part by California Corporations Code Section 25506.

THIRD AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Laches)

110. Plaintiffs knew, or in the exercise of reasonable care should have known of the events and conditions of which they complain, if any existed (and without admitting that any existed), at a time not presently known to defendant Holmes but known to plaintiffs, and in all events prior to the respective collapses of Sebag and FSSC. Notwithstanding such knowledge, plaintiffs failed to take any action to avoid or reduce the injuries now alleged, including, without limitation, any action by way of resort to judicial remedies, prior to instituting this action. Plaintiffs are barred, therefore, in whole or in part by the doctrine of laches from recovery.

FOURTH AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Estoppel)

111. Plaintiff trustees or their predecessors in interest knew of the misrepresentations, omissions and manipulative scheme alleged in their Complaint, if any existed (and without admitting that any existed), but continued to make markets in the securities affected thereby. Defendant Holmes reasonably and in good faith relied upon the market price of the securities as well as upon the other acts and statements of plaintiffs or their predecessors in interest, in making any statements and undertaking any acts alleged in plaintiffs' Complaint. Plaintiffs are estopped, therefore, in whole or in part from recovery.

FIFTH AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Failure to Avoid or Mitigate Damages)

112. After the respective collapses of Sebag and FSSC, plaintiffs failed to take any or all actions reasonable or necessary under the circumstances to avoid or reduce the injuries alleged. Plaintiffs are therefore barred in whole or in part by their failure to avoid or mitigate damages from recovery.

SIXTH AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Plaintiffs at Fault)

113. Plaintiffs or their predecessors in interest are at fault in causing the injuries alleged and are barred, therefore, in whole or in part from recovery.

114. Plaintiffs, by virtue of their or their respective predecessors' knowledge of and participation in the alleged misrepresentations, omissions and manipulative scheme, if any, are barred in whole or in part by the doctrine of unclean hands from recovery.

SEVENTH AFFIRMATIVE DEFENSE TO ALL CLAIMS FOR RELIEF

(Unreasonable Reliance)

115. Plaintiffs did not rely on alleged misrepresentations or omissions, if any, by defendant Holmes. Any reliance by plaintiffs was, in any event, unreasonable under all of the circumstances. Plaintiffs are barred, therefore, in whole or in part from recovery.

116. Plaintiffs or their predecessors in interest, through the exercise of reasonable diligence, could have discovered all of the facts allegedly misrepresented or concealed by defendant Holmes. Plaintiffs unreasonably and recklessly failed to conduct any and all investigations reasonable or necessary under the circumstances into such facts, notwithstanding that they were professional dealers and otherwise sophisticated investors in securities and who knew or should have known facts sufficient to put them on notice of a need to inquire further as to such facts. Plaintiffs are barred, therefore, in whole or in part from recovery.

EIGHTH AFFIRMATIVE DEFENSE TO
ALL CLAIMS FOR RELIEF

(Collateral Estoppel)

117. The Complaint and claims for relief, to the extent that they raise and rely upon issues of fact that were determined in *SEC v. Newport Securities Corp.*, are barred in whole or in part by the doctrine of collateral estoppel.

NINTH AFFIRMATIVE DEFENSE TO
ALL CLAIMS FOR RELIEF

(Lack of Standing)

118. At no time were plaintiffs either purchasers or sellers of the securities of Aero Systems. Plaintiffs therefore lack standing under Section 10 or Rule 10b-5 of the Exchange Act to recover on the Complaint.

119. Plaintiff SIPC's recovery is limited to such claims as it may acquire by right of subrogation through payments actually made to customers of Sebag and FSSC, respectively, on the net equity claims of such customers. SIPC is therefore barred from recovery on the Complaint of any sums in excess of such payments to customers, including, without limitation, any claims for treble or punitive damages.

120. Plaintiff SIPC insured only the value of securities of customers left on deposit with Sebag and FSSC as of the dates of the filings of their respective liquidations. The net equity claims asserted by SIPC based upon such values were not the proximate result of any of defendant Holmes' alleged acts. Plaintiff SIPC is barred, therefore, in whole or in part from recovering against Holmes on the Complaint.

121. Plaintiff trustees' recovery is limited by law to such claims as might have been asserted against defendant by Sebag or First State themselves. Plaintiff trustees lack standing to assert claims on behalf of customers of Sebag or FSSC. Plaintiff trustees are barred, therefore, in whole or in part from recovery on the Complaint.

122. Sebag and FSSC, through their agents, employees, officers, directors and shareholders, were knowing participants in the manipulative scheme and misrepresentations and omissions alleged. Plaintiff trustees are barred, therefore, in whole or in part from recovery.

TENTH AFFIRMATIVE DEFENSE TO
ALL CLAIMS FOR RELIEF

(Good Faith and Due Diligence)

123. Defendant Holmes duly and diligently performed all investigations of the facts underlying the statements or omissions alleged to have been made or omitted to have been made by him. Any statements by defendant Holmes were made in good faith and without knowledge of any falsity thereof or of any need to disclose any fact not disclosed. Defendant Holmes honestly believed in the truth and completeness of all statements allegedly made by him, and could not in the exercise of reasonable diligence have discovered the falsity or incompleteness thereof, if any. Plaintiffs are barred, therefore, in whole or in part from recovery.

ELEVENTH AFFIRMATIVE DEFENSE TO
ALL CLAIMS FOR RELIEF

(Set Off)

124. To the extent that any of plaintiffs' claims against any other persons arising out of the same transactions or occurrences alleged in plaintiffs' Complaint have been or are compromised prior to judgment herein, defendant Holmes is entitled to set off the entire amount of such compromised claims against his alleged liability to plaintiffs.

FIRST AFFIRMATIVE DEFENSE TO PLAINTIFFS'
SEVENTEENTH (RICO) CLAIM FOR RELIEF

(No Criminal Proceeding)

125. Defendant Holmes is not guilty of, and has not been adjudged guilty of nor indicted for or charged with,

any of the criminal acts alleged in the Complaint. Plaintiffs are barred, therefore, in whole or in part from recovering on the Seventeenth Claim for Relief.

SECOND AFFIRMATIVE DEFENSE TO PLAINTIFFS'
SEVENTEENTH (RICO) CLAIM FOR RELIEF

(Statute of Limitations)

126. The Seventeenth Claim for Relief is barred in whole or in part by Section 338(1) of the California Code of Civil Procedure.

127. The Seventeenth Claim for Relief is barred in whole or in part by Section 340(1) of the California Code of Civil Procedure.

128. The Seventeenth Claim for Relief is barred in whole or in part by Section 343 of the California Code of Civil Procedure.

THIRD AFFIRMATIVE DEFENSE TO PLAINTIFFS'
SEVENTEENTH (RICO) CLAIM FOR RELIEF

(No Relationship to Organized Crime)

129. The enterprise alleged in the Complaint had no involvement or relationship with any person engaged in organized crime or with any organized crime activities. Plaintiffs are barred, therefore, in whole or in part from recovery.

FOURTH AFFIRMATIVE DEFENSE TO
PLAINTIFFS' SEVENTEENTH (RICO)
CLAIM FOR RELIEF

(Alternative Remedies)

130. Plaintiffs have adequate remedies under the federal securities laws, including Section 10 and Rule

10b-5 of the Exchange Act for all injuries allegedly caused by defendant Holmes, and are barred, therefore, in whole or in part from recovering on their Seventeenth Claim for Relief.

FIFTH AFFIRMATIVE DEFENSE TO PLAINTIFFS' SEVENTEENTH (RICO) CLAIM FOR RELIEF

(No RICO Injury)

131. Plaintiffs have not been injured by reason of a violation of 18 U.S.C. Section 1962, and are barred, therefore, in whole or in part from recovery on the Seventeenth Claim for Relief.

132. Plaintiffs have not suffered any competitive injury as a result of any acts of defendant Holmes alleged in the Complaint, and are barred, therefore, in whole or in part from recovery on the Seventeenth Claim for Relief.

SIXTH AFFIRMATIVE DEFENSE TO PLAINTIFFS' SEVENTEENTH (RICO) CLAIM FOR RELIEF

(No Vicarious Liability)

133. Defendant Holmes cannot be held vicariously liable under 18 U.S.C. Section 1962 or 18 U.S.C. Section 1964 for the acts of any other person or entity alleged in the Complaint. Plaintiffs are barred, therefore, in whole or in part from recovery on the Seventeenth Claim for Relief.

SEVENTH AFFIRMATIVE DEFENSE TO PLAINTIFFS' SEVENTEENTH (RICO) CLAIM FOR RELIEF

(Denial of Due Process)

134. Because 18 U.S.C. Section 1962 seeks to deprive defendant Holmes of liberty or property without due process of law, in that it purports to render defendant Holmes answerable for the acts of other persons whose acts and whose relationship to defendant Holmes through an alleged "enterprise" or "pattern" or activity are fortuitous, unknown, and not reasonably knowable or reasonably foreseeable by defendant Holmes, plaintiffs' claim based upon that section is barred by the Fifth Amendment to the United States Constitution.

Dated: April 3, 1985

Respectfully submitted,
JACK I. SAMET
BUCHALTER, NEMER, FIELDS, CHRYSTIE & YOUNGER

/s/ Jack I. Samet
Jack I. Samet
Attorneys for Defendant
ROBERT G. HOLMES, JR.

VERIFICATION

STATE OF CALIFORNIA, COUNTY OF

I have read the foregoing _____

_____ and know its contents.

X CHECK APPLICABLE PARAGRAPH

___ I am a party to this action. The matters stated in it are true of my own knowledge except as to those matters which are stated on information and belief, and as to those matters I believe them to be true.

___ I am ___ an Officer ___ a partner ___ a ___ of ___

_____

a party to this action, and am authorized to make this verification for and on its behalf, and I make this verification for that reason. I have read the foregoing document and know its contents. The matters stated in it are true of my own knowledge except as to those matters which are stated on information and belief, and as to those matters I believe them to be true.

___ I am, one of the attorneys for _____ a party to this action. Such party is absent from the county of aforesaid where such attorneys have their offices, and I make this verification for and on behalf of that party for that reason. I have read the foregoing document and know its contents. I am informed and believe and on that ground allege that the matters stated in it are true.

Executed on _____ 19___, at _____ California.

_____

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

_____

Signature

ACKNOWLEDGEMENT OF RECEIPT OF DOCUMENT
(other than summons and complaint)

Received copy of document described as _____

_____

on _____ 19___.

_____

Signature

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the county of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is: 700 South Flower Street, Los Angeles, California 90017-4183.

On Apr. 3, 1985, I served the foregoing document described as Answer of Defendant Robert G. Holmes, Jr. to First Amended Complaint for Damages on the parties having appeared in this action by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid in the United States mail at: Los Angeles, California 90017. addressed as follows:

PLEASE SEE ATTACHED LIST FOR NAMES OF PARTIES SERVED

XX (BY MAIL) I caused such envelope with postage thereon fully prepaid to be placed in the United States mail at Los Angeles, California.

___ (BY PERSONAL SERVICE) I caused such envelope to be delivered by hand to the offices of the addressee. Executed on April 3, 1985 at Los Angeles, California.

___ (State) I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

X (Federal) I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

STUARTS EXBROOK; TIMESAVER (REVISED 7/81)
(May be used in California State or Federal Courts)

Signature
Michele E. Mason

SERVICE LIST
IN SIPC v. VIGMAN, et al.
(Pleadings)

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al., Plaintiffs, vs. SEYMOUR VIGMAN, et al., Defendants. AND CONSOLIDATED ACTIONS.	CASE NO. CV 83-4742-AWT (Tx) [Consolidated Cases] DEFENDANT ROBERT G. HOLMES, JR.'S STATEMENT OF UNCONTROVERTED FACTS AND CONCLUSIONS OF LAW IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT WITH RESPECT TO CLAIMS ASSERTED UNDER THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO) (AMENDED) DATE: October 17, 1988 TIME: 10:00 a.m. PLACE: Courtroom of the Honorable A. Wallace Tashima

Defendant Robert G. Holmes, Jr. ("Holmes") respectfully submits the following Amended Statement of Uncontroverted Facts and Conclusions of Law to supercede his previously filed Statement of Uncontroverted Facts and Conclusions of Law filed pursuant to Local Rule 7.14.1 of the above-entitled Court in support of his Motion For Summary Judgment With Respect To Claims Asserted Under The Racketeer Influenced And Corrupt Organizations Act (RICO) (the "RICO Motion").

UNCONTROVERTED FACTS

1. Neither Holmes nor Aero Systems was involved in any significant business or personal transaction with any of the following entities or with any officer or employee of any of these entities:

> Creditbank, Inc. (Exhibit 1, Calonge Depo. 4-29-87, p. 9:19-10:5)
>
> (all deposition testimony herein cited is contained in a set of Exhibits filed concurrently herewith).

Ibebafin, S.A. (no evidence of any connection with Holmes or Aero Systems)

Keops, S.A. (no evidence of any connection with Holmes or Aero Systems)

Talingo Corporation (no evidence of any connection with Holmes or Aero Systems)

Tula Corporation (no evidence of any connection with Holmes or Aero Systems)

2. Holmes was not involved in any significant transactions nor had any significant business or personal communications with any of the following individual "RICO

Defendants": Rodger Garrity, (Exhibit 9, Holmes Depo. of 12-4-87, p. 269:6-270:9) Frankie Mae Garrity; (no evidence of connection with Holmes): Herbert Frank (Exhibit 6, Frank Depo. of 12-8-87 and 12-9-87, p. 137:14-138:8; Exhibit 7, Holmes Depo. of 12-3-87, p. 156:24-157:6), Velma Shaw (no evidence of any connection with Holmes), Jose Luis Calonge (Exhibit 1, Calonge Depo. of 4-29-87, p. 9:19-23), Delores Owens Cipparrone, (Exhibit 10, Holmes Depo. of 2-23-88, p. 1197:17-1198:2); Jay Dash (Exhibit 2, Dash Depo. of 7-28-87, p. 60:20-22), Phillip Dash (Exhibit 11, Holmes Depo. of 2-24-88, p. 1327:22-1328:2), Elliott Eiseman (Exhibit 4, Eiseman Depo. of 5-7-86, p. 215:12-19), David Goldman (no evidence of connection found), Jack Haber (Exhibit 8, Haber Depo. of 7-6-86, p. 59:16-65:15), Jose Camprubi Sala (no evidence of connection on [sic] found).

3. Aero Systems had limited business transactions involving Aerosonic, the sale of altimeters and other avionics products to Aero Systems over the last 20 years. (Holmes Depo. of 12-3-87, p. 155:17-156:17).

4. In approximately 1970, Aerosonic merged with an entity called Instrument Technologies which was a subsidiary of Aerotech. Aerotech was at one time a subsidiary of Aero Systems, other than this remote connection to Aero Systems, and its limited sales of avionics products to Aero Systems, Aerosonic had no other significant business or other relationship with Holmes or Aero Systems. (Exhibit 6, Frank Depo. of 12-8-87 and 12-9-87, p. 120:14-19, p. 122:15-22).

5. Herbert Frank, who was President of Aerosonic, had no personal knowledge of, or relationship with,

Holmes. (Exhibit 6, Frank Depo. of 12-8-87 and 12-9-87, p. 137:14-138:8; Exhibit 7, Holmes Depo. of 12-3-87, p. 156:24-157:3).

6. Holmes had no position of authority, and exercised no control, over any of the following entities:

> Executive Securities (Exhibit 3, Eiseman Depo. of 11-22-85, p. 42:17-43:5, p. 50:17-52:13, p. 53:9-54:11)
>
> Newport Securities (Exhibit 16, Susson Depo. of 2-22-88, p. 22:3-33:24)
>
> First State Securities Corporation ("FSSC") (Exhibit 3, Eiseman Depo. of 11-22-85, p. 63:13-23)
>
> Joseph Sebag, Inc. ("Sebag") (Exhibit 15, Myers SEC Testimony, 9-1-85, p. 11:17-13:7, p. 30:4-18, p. 36:1-39:6)

7. Between 1976 and 1981, FSSC and Sebag traded Aero Systems securities on the over-the-counter market ("OTC") and Holmes had an account at FSSC but neither Holmes nor Aero Systems had any other transactions with FSSC and Sebag whichever not related to the trading of Aero Systems securities. Holmes did not direct or control the trading of OTC stocks, including Aero Systems stock, at FSSC or at Sebag. (*See* No. 3 above).

8. Holmes' only interest at FSSC was as a customer. Holmes had no interest in and was not a customer at Sebag. (Exhibit 5, Foley Depo. of 6-22-88, p. 265:23-266:14).

9. Holmes has never been employed by J.C. Roberts, or Executive Securities, or by Newport Securities, or by either FSSC or Sebag. (*See* No. 3 above.)

10. Holmes was introduced to Seymour Vigman ("Vigman") in 1966 by Murray Silvershein. Silvershein was a friend of Ralph Gordon, who was Aero Systems' accountant at the time. (Exhibit 11, Holmes Depo. of 2-23-88, p. 1132:19-23 and Exhibit 12, Holmes Depo. of 2-25-88, p. 1371:5-22).

11. At the time Holmes met Vigman, Vigman was a registered broker at J.C. Roberts and had been in the securities brokerage business since at least 1962.

12. At the time Holmes met Vigman, Holmes was interested in a public offering of Aero Systems stock, in part, to make a market for Aero Systems stock in which Holmes' family could easily sell their Aero Systems stock to generate income. Holmes did not believe that his family could effectively operate Aero Systems to generate income for their support. (Exhibit 11, Holmes Depo. of 2-23-88, p. 1155:11-1156:25).

13. In 1966 Vigman, through J.C. Roberts, agreed to underwrite the public offering of Aero Systems' securities of up to 100,000 shares, based upon Aero Systems' financial statements presented to him by Holmes and Gordon. (Exhibit 11, Holmes Depo. of 2-23-88, p. 1155:11-1156:18).

14. Aero Systems' 1967 public offering was accomplished through J.C. Roberts which commenced to make a market in Aero Systems' securities in 1967, around 30 days after the offering. (Exhibit 17, Vigman Depo. of 5-5-88, p. 713:15-19).

15. Joseph Lugo ("Lugo") was an employee at J.C. Roberts in 1964 until 1967 but worked only in the back office and not as a broker. Holmes had no significant

contact with Lugo while Lugo was at J.C. Roberts. (Exhibit 14, Lugo Depo. of 11-9-87, p. 36:7-14 and Exhibit 11, Holmes Depo. of 2-23-88, p. 1146:3-16).

16. Holmes was not a party to the SEC's consent decree against Vigman in 1967 which led to the winding up of J.C. Roberts. The conduct alleged by the SEC to be unlawful and which led to the consent decree against Vigman in 1967 did not involve Holmes. The SEC's allegations in such respect did not implicate Holmes in Vigman's alleged wrongdoing. (See Exhibit "19").

17. Holmes was not involved in any decision by Vigman to purchase or resell any Aero Systems' warrants issued through J.C. Roberts that were allegedly not also offered to the public in or around 1967. (Exhibit 11, Holmes Depo. of 2-23-88, p. 1166:12-25).

18. The price of Aero Systems' securities traded by Executive Securities, Newport Securities and Garrity was the true and intrinsic price of that stock.

19. Holmes never participated in the management of, or making of decisions at, either Executive Securities or Newport Securities. (Exhibit 3, Eiseman Depo. of 11-22-85, pp. 42:17-43:5, p. 50:17-52:13, p. 53:9-54:11 and Exhibit 16, Susson. 2-22-88, p. 22:3-33:24; Exhibit 7, Holmes Depo. of 12-3-87, p. 146:12-147:6).

20. There were no mechanisms in place at either Executive Securities or Newport Securities for controlling or directing Holmes' or Aero Systems' affairs and in fact no such control or direction ever occurred. (*See* par. 19 above).

21. The only management "position" or "role" which Holmes held in any organization amongst the identified defendants was in Aero Systems. (*See* par. 6 above).

22. Aero Systems was the only entity in which Holmes had operational involvement or control. (*See* par. 6 above).

23. Holmes had no ownership interest in, nor controlled or directed the affairs of, Creditbank. (Exhibit 1, Calonge Depo. of 4-29-87, p. 9:19-10:5).

24. Holmes' sole interest in Bunnington was as a shareholder.

25. Holmes held no management position in Bunnington and did not control or direct the affairs of Bunnington. (Exhibit 13, Holmes Depo. of 5-5-88, p. 2576:2-16).

26. When Aero Systems issued warrants as part of its public offering in 1967, this was a capital-raising endeavor also intended by Holmes to create a public market for Aero Systems securities. (Exhibt [sic] 11, Holmes Depo. of 2-23-88, p. 1157:9-13).

27. Holmes did not make any false representations to any person in connection with the issuance of Aero Systems warrants in 1967. (Exhibit 11, Holmes Depo. or [sic] 2-23-88, p. 1166:12-24).

28. Holmes did not make any false representations to any person in connection with the merger of DCS Financial and Aero Systems in 1976. (*See* Exhibit "18").

29. Aero Systems merger with DCS Financial in 1976 was, in part, motivated by Aero Systems' desire to regain the contract rights to the DC 10 aircraft parts which DCS Financial had obtained from Aero Systems by providing the cash Aero Systems needed for the down-payment to Frederick D. Ayer ("Ayer"). (Exhibit 12, Holmes Depo. of 2-24-88, p. 1283:25-1285:20; Exhibit 13, Holmes Depo. of 2-25-88, p. 1440:17-1441:6).

30. In 1976, at or about the time of the DCS Financial merger transaction, Holmes, and the management at Aero' Systems, did not think it convenient for Aero Systems to use its operating funds for the cash down-payment to Ayer for the contract rights to the crashed DC 10 airline parts. (Exhibit 12, Holmes Depo. of 2-24-88, p. 1287:5-11).

31. In or around November 1975, Holmes discussed the purchase of the DC 10 airline parts with Vigman, a controlling shareholder in DCS Financial. (Exhibit 12, Holmes Depo. of 2-24-88, p. 1335:14-1336:20).

32. Isadore Diamond, who was a shareholder in DCS Financial, proposed that DCS Financial purchase one-half of Aero Systems' rights to the airline parts for $50,000 and advance to Aero Systems $100,000 for the deposit to be made to Ayer. (Exhibit 12, Holmes Depo. of 2-24-88, p. 1336:2-1337:5).

33. The DCS Financial merger was accomplished in mid July 1976. (Exhibit 12, Holmes Depo. of 2-24-88, p. 1396:12-1397:8).

34. The DCS Financial merger with a subsidiary of Aero Systems enabled Aero Systems to obtain $250,000 in

cash which DCS Financial had on hand. (Exhibit 13, Holmes Depo. of 2-25-88, p. 1440:17-24).

35. The DCS Financiai merger enabled Aero Systems to reclaim one-half of the Ayer DC 10 parts contract rights which Aero Systems had initially transferred to DCS Financial in partial consideration of the cash deposit advance from DCS Financial. (Exhibit 13, Holmes Depo. of 2-25-88, p. 1440:17-1441:12).

36. Springwater Manufacturing was a profitable subsidiary of DCS Financial which Aero Systems acquired as part of the merger transaction. (Complaint, par. 78) (Exhibit 13, Holmes Depo. of 2-25-88, p. 1440:17-1441:6).

37. The DCS Financial merger transaction with Aero Systems enabled Aero Systems to claim DCS Financial's tax loss carry-forward to the benefit of Aero Systems in accordance with applicable tax laws. (Exhibit 13, Holmes Depo. of 2-25-88, p. 1440:17-1441:12).

38. As part of the DCS Financial merger transaction, Springwater Manufacturing was required to maintain its net worth as a condition to Aero Systems' transferring to the DCS Financial shareholders certain Aero Systems' shares which were held in escrow. (Exhibit 13, Holmes Depo. of 2-25-88, p. 1493:22-24, p. 1494:18-20, p. 1495:1-5).

39. As part of the DCS Financial merger transaction, Springwater Manufacturing had to repay to Aero Systems at least $200,000 of Aero Systems' then outstanding debt to DCS Financial. (Exhibit 13, Holmes Depo. of 2-25-88, p. 1495:6-20).

40. As part of the DCS Financial merger transaction, Springwater Manufacturing was required to obtain long term financing. (Exhibit 13, Holmes Depo. of 2-25-88, p. 1495:21-1496:24).

CONCLUSIONS OF LAW

1. There is no identifiable "racketeering enterprise" that is separate and distinct from the alleged pattern of racketeering activity.

2. There is no identifiable "racketeering enterprise" that is an ongoing organization in fact of ascertainable structure amongst the "RICO Defendants."

3. Holmes did not invest any income derived from a pattern of racketeering activity in any enterprise engaged in interstate commerce.

4. Holmes did not acquire, through a pattern of racketeering activity, an interest in or control of an enterprise.

5. Holmes was not employed or associated with an enterprise and did not conduct the affairs of any enterprise through a pattern of racketeering activity.

6. Holmes did not conspire to violate Sections 1962(a); 1962(b); 1962(c) of RICO 18 U.S.C. 1961 *et seg.*

7. The alleged predicate acts are not offenses involving fraud in the sale of securities or bankruptcy fraud under Title 11, U.S.C., or acts indictable as mail or wire fraud under Title 18, U.S.C. §§ 1341, 1343.

8. The alleged "predicate acts" are not racketeering activity as defined in RICO Section 1961(1).

9. There are not at least two "predicate acts" occurring within ten years of each other which are sufficiently related or continuous to constitute a "pattern" of racketeering activity.

10. The "predicate acts" alleged did not cause the injuries of the Securities Investor Protection Corporation ("SIPC") and/or the injuries of the Trustees appointed by SIPC to liquidate Joseph Sebag, Inc. ("Sebag") and First State Securities Corporation ("FSSC").

11. SIPC does not meet the "purchaser-seller" requirements for standing to assert RICO claims which are predicated upon violation of Section 10(b) and Rule 10b-5 of the 1934 federal Securities Exchange Act.

DATED: August 15, 1988

Respectfully submitted,

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By /s/ Stephen K. Lubega
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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al., Plaintiffs, v. SEYMOUR VIGMAN, et al., Defendants. AND CONSOLIDATED ACTIONS.	Case No. CV 83-4742-AWT (Tx) (Consolidated Cases) STATEMENT OF BACKGROUND AND FACTS [Filed Concurrently with Memoranda of Points and Authorities in Opposition to Holmes' Motions for Summary Judgment] [Filed Concurrently with Plaintiffs' Statement of Genuine Issues] DATE: October 17, 1988 TIME: 10:00 a.m. PLACE: Courtroom of Honorable A. Wallace Tashima

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I

INTRODUCTION

The entire thrust of Defendant Robert G. Holmes, Jr.'s ("Holmes") Motion for Summary Judgment is that the conduct of Defendant Joseph A. Lugo, Jr. ("Lugo") and other defendants were independent forces for which Holmes cannot be accountable. The facts, as hereinafter set forth, show that Holmes is not only culpable, but along with defendants Seymour Vigman ("Vigman") Isadore Diamond ("Diamond"), Martin Blumenthal ("Blumenthal"), Lugo and Rodger Garrity ("Garrity"), was one of the principal characters in the scheme to manipulate Aero Systems, Inc. ("Aero Systems") and prices of other over-the-counter securities.

Lugo did not act alone. Rather, the scheme, as will be shown, required and had participants each with distinct roles and responsibilities, with each profiting in his own way, and each contributing to the collapse of First State Securities Corporation (*"FSSC"*) and Joseph Sebag Incorporated (*"Sebag"*).

II

STATEMENT OF BACKGROUND AND FACTS

A. HOLMES IS LIABLE FOR DAMAGE CAUSED BY THE MANIPULATIVE SCHEME

As more fully set forth below, Holmes was a longtime friend and confident of Lugo and Vigman. His relationship with Lugo and Vigman enabled him to successfully manipulate Aero Systems and Bunnington stocks. More importantly, however, the Aero Systems manipulation

was only a component of a larger scheme to manipulate six different securities. The manipulative schemes culminated with the demise of FSSC and Sebag, thus causing harm to the Trustees and SIPC.

The manipulated securities were Aerosonic, Aero Systems, Bunnington, Creditbank, Dash and Osrow. Holmes' involvement with the grand scheme included the following acts: (1) the manipulation of Aero Systems' stock which benefited Vigman, who sold out large positions at the precise moment that false press releases caused the price to escalate. Lugo then resold the Aero Systems stock which harmed FSSC, when Lugo used profits from Aero Systems sales to increase FSSC's inventory position in Bunnington and Aerosonic stock, in a further attempt to manipulate those stocks for the benefit of Holmes, among others; (2) the utilization of proceeds from the sale of Aero Systems stock at manipulated prices to purchase Bunnington stock, when Vigman failed to demand immediate payment. This created a false cash supply at FSSC, enabling Lugo to buy up Bunnington and Aerosonic stock, thereby creating the appearance of market activity when, in fact, there was no *bona fide* market activity in Bunnington or Aerosonic stock; (3) the direct participation in a manipulation of Bunnington stock through the dissemination of a false and misleading press release to a stock broker; (4) the direct manipulation of Bunnington stock through a pattern of trading consisting of purchasing Bunnington stock at FSSC in relatively large blocks, and selling the stock at other brokerage houses in small increments to create the appearance of a wellspread market that did not exist; (5) the parking of 5,000 shares of Bunnington stock at a crucial time when

Lugo needed to get Bunnington stock off FSSC's books thereby enabling FSSC to stay in business past the point of a net capital deficiency; (6) the agreement of Holmes to allow his company, Aero Systems, to serve as a retail outlet for a computer marketed by Dash Industries, thereby enabling Dash Industries to make false and misleading statements regarding its business and prospects.

Plaintiffs submit that Holmes was a knowing participant in the manipulative scheme to inflate the price of all six securities. Holmes' knowledge of the scheme's scope and complexity is not only evident in the acts identified above, but can also be inferred from his long-standing relationships with other players in the scheme, and the personal benefit he realized from marketing securities. Those relationships with his co-defendants are described below.

Plaintiffs seek to prove that the course of Holmes' conduct, stretching back to the mid 1960's, shows a method of operation that became highly sophisticated by 1980-1981. Further, the relationships of many years and acts of many years ago indicate the formation of a conspiracy to manipulate securities that continues to this day. Moreover, many of the activities outlined below are predicate acts under the Racketeer Influenced and Corrupt Organizations Act.

B. HOLMES AND AERO SYSTEMS, INC.

Aero Systems has been described as " . . . a company specializing in buying, reconditioning and recertifying, through the Federal Aviation Administration, used instruments and parts from junked airplanes, and then

selling them as replacement parts" (Exh. 2621, p. 9). The industry refers to operations like Aero Systems as "junk dealers" (Hayden, pp. 58-59).

1. Holmes' Control Over Aero Systems.

Holmes strictly controlled the activities of Aero Systems. He was President, Chairman of The Board of Directors and Chief Executive Officer. (Jackson, p. 6; Aero Systems Annual Reports 1975-1982, Exhs. 5253-5261).

Holmes admits that he has been Chairman of the Board of Directors and President of Aero Systems since 1962. (Holmes Response to Requests for Admissions ["RFA"] 112-115). At the time Aero Systems "went public" in 1967, the preliminary prospectus described Holmes as "founder, executive officer and director of the company since it business inception in 1951" (Exh. 5290). Between 1976 and 1981, Holmes and his wife held between 38% and 20% of the issued and outstanding stock in Aero Systems (Exhs. 5262, 5263, 5264, 5266, 5267 and 5268). Holmes did not hold regular Board Meetings (Jackson, pp. 8-9; Holmes, p. 2374). Holmes was involved in nearly every aspect of the company, and had full control over everything that was going on (Jackson, pp. 7-8; 30; 48; 54).

In addition to his strict oversight of all of the affairs of Aero Systems, Holmes always held a controlling block of Aero Systems common stock. Holmes was a controlling person within the meaning of the Federal securities laws as of October 13, 1978 (RFA 803).

2. Holmes' philosophy regarding "values" underlying Aero Systems stock price.

Since Aero Systems became a corporation in March 1967, Holmes developed and cultivated a relationship with Aero Systems' market makers which Holmes calls "Sponsorship." (Holmes, Exh. 3955). Holmes believes that "Sponsorship" is "the real secret to the future success of any public company" (*Id.*). Without it, "[t]here is no one to create new market interest in the Company. Without new interest the stock price deteriorates . . . " (*Id.*). Holmes did not believe that the controlling factors concerning a stock's price on the open market are traditional measures such as net worth or earnings or book value or sales of the company (Holmes, p. 2643). Rather, Holmes believed, that by simply maintaining a particular kind of relationship with his market makers, he could maintain a high public value of Aero Systems shares with little or no economic basis compared to those companies which had high earnings per share, low price to earnings ratios, dividends, high sales and high net worth (Holmes, Exh. 3954).

Rather than recognize the traditional basis for the value of a stock, it is significant to the pattern of facts in this case that Holmes believes that the key ingredient to the value of a company's stock is " . . . the way that it [the company] presents itself and the way that the company *appears* to the brokers who may be interested in the stock, what they believe or perceive to be the future potential for that company" (Holmes, p. 2644) (emphasis added).

Holmes acknowledges that the CD-3000 (a "fuel management" device which was the subject of numerous false public statements,) is a key example of a device used by

Holmes to influence "Sponsors" who might "believe or perceive [it] to be the future potential" for Aero Systems (Holmes, p. 2644). Indeed, it is exactly this philosophy, belief and practice, united with what his "Sponsors" might believe or perceive, which underlines Holmes' deception of the public after Aero Systems acquired the "world-wide distribution rights" to the CD-3000 on March 27, 1980.

C. ROBERT HOLMES AND SEYMOUR VIGMAN.

1. Vigman's Influence Over Holmes.

Holmes and Defendant Vigman are, and were since 1966, extraordinarily close.[1] Both Holmes and Vigman described their relationship as one of "friends" (Holmes, p. 1199; Vigman p. 196).[2]

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[1] Holmes was introduced to Vigman in 1966 by Vigman's friend, Murray Silvershein, President of MHS, Inc. (Holmes, p. 1154). Vigman introduced Holmes to nearly all of the people involved in the manipulation. At that time Lugo was working in the back office at Vigman's brokerage firm and had worked for Vigman since high school (Eiseman, pp. 29-30, 11/22/85). Holmes first met Lugo when Lugo was working for Vigman (Lugo, p. 701). Vigman introduced Blumenthal to Holmes (Blumenthal, p. 962). Vigman introduced McNeil to Holmes (McNeil, p. 107). Vigman introduced Holmes to Diamond (RFA 251). Diamond met both Holmes and Blumenthal at a social function at Vigman's home (Diamond, pp. 34, 54). Vigman also introduced Lugo to Garrity in 1966 or 1967 (Garrity, pp. 21-23, 12/16/80). Lugo introduced Garrity to Holmes (RFA 574).

[2] The two have met in Las Vegas approximately 40-50 times over the past twenty years (Vigman, p. 160; Holmes, pp.

(Continued on following page)

The relationship went far beyond friendship. Holmes considered Vigman his financial advisor (Holmes, pp. 35-37) and Holmes admits that he has used Vigman as his "financial sounding board" since 1967 (*Id.*; Vigman, pp. 201-203; 216).[3]

A much sharper image of Vigman's control and influence over Holmes is shown by Michael Porter's[4] testimony of a March 1980 meeting with the two concerning the CD-3000. Porter was introduced to Vigman by Holmes as Holmes' "financial consultant, best friend and

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1326-1327). Holmes has paid several social visits to Vigman from Florida to California (Vigman, pp. 198-199) and Holmes was a guest at Vigman's daughter's wedding (*Id.*). Defendant Jack Haber also met with Vigman and Holmes in Las Vegas (Vigman, p. 159). Blumenthal met Vigman and Holmes in Las Vegas (Vigman pp. 494-495; Blumenthal, p. 264). Diamond Met Blumenthal in Las Vegas (Diamond, p. 55).

[3] Vigman has also been Holmes' financial "source." Holmes has borrowed substantial sums of money over the past twenty years from Vigman on at least three occasions (Holmes, p. 2451). These include loans of approximately $150,000 and $63,000 (Holmes, pp. 1275-1278). Holmes never paid Vigman any interest for the loans (Holmes, p. 3199). Vigman also arranged a loan for Aero Systems at the Bank of America (Garrity, pp. 32-33, 12/16/86). Vigman guaranteed a loan for Holmes (Vigman, p. 521). As Vigman said, if Holmes had wanted to borrow $50,000, and had Vigman had it, it would be "fine with him" (Vigman, p. 524).

[4] Michael Porter is a partner in the financial public relations firm of Porter, LeVay & Rose. (Porter, p. 6) As explained below, Porter, LeVay & Rose was the financial public relations firm for Aero Systems beginning in early 1980.

director" of Aero Systems (Porter, pp. 35-36).[5] Vigman did not deny it (*Id*). Vigman took control of the meeting and "it was as if Vigman was the resident genius" (Porter, p. 36). Vigman told Porter at the meeting that he was Holmes' "confidant[e]" and that Holmes "really would not make a decision without first talking to Vigman." (Porter, p. 36).

Vigman claims to have never been paid by Holmes for any of Vigman's financial advice (Vigman, p. 203). However, since about February, 1987, Vigman has been paid $5,000 per month by Hierax, a subsidiary of Aero Systems, ostensibly for introducing new products to the subsidiary (Holmes, p. 1267, 1269; 1684-1685; Vigman, pp. 272-274). This *de facto* annuity is not the only manner in which Vigman, Vigman's relatives and Vigman's companies have been paid off by Holmes for many years as will be shown below.

The pattern of racketeering between 1979 and 1981 resulting in the demise of FSSC and Sebag was a repetition of previous similar conduct and predicate activity under RICO.

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[5] Holmes' representation was untrue. Vigman never has been an official member of Aero Systems' Board of Directors. However, as the facts show, Vigman has assumed the role and has acted as a *de facto* member of the Board, without Vigman's influence on Holmes being disclosed to the public.

2. The Development of the Holmes-Vigman Relationship.

   a. J.C. Roberts and Aero Systems' Initial Public Offering.

At the time of their first meeting in October 1966, Vigman was president of J.C. Roberts & Co., a registered securities broker-dealer located in Miami, Florida (Holmes, p. 1132).[6] Although Homes didn't really need the money from a public offering of Aero Systems stock (Holmes, p. 1156), it was Vigman's recommendation to nevertheless "go public" with only 100,000 shares. The number "just felt right" to Vigman (Holmes, p. 1156).

Thus, J.C. Roberts acted as underwriter for the initial public offering of Aero Systems stock at $3.00 per share in March 1967 (Holmes, pp. 1146, 1244). It was Vigman who decided on the price per share (Holmes, p. 1159), and Vigman had full control of the 100,000 shares offered for sale (Holmes, p. 1161). Thereafter, J.C. Roberts made a market in Aero Systems (Vigman, p. 455). More importantly for Vigman, it was he who would reap windfall profits from the public offering.[7]

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[6] Lugo was employed by Vigman at J.C. Roberts first as a cashier and later in charge of the "back office;" Lugo was introduced to Holmes by Vigman. (Holmes, p. 1146; Vigman, p. 29-30). Holmes also met Elliot Eiseman during this same period of time (Holmes, p. 1147).

[7] During the processing of the Aero Systems initial public offering in February of 1967, and before the stock was offered to the public, Vigman and J.C. Roberts came under the scrutiny of the SEC for fraudulent trading practices (Vigman, pp. 653-658; Exh. 6579). The SEC alleged the manipulation of the

(Continued on following page)

The Aero Systems prospectus, as originally drafted, provided for J.C. Roberts to receive warrants to purchase 25,000 shares of Aero Systems stock as additional underwriter's compensation (Exh. 5290) (Vigman, p. 687). However, the Florida Securities Commission refused to approve the additional underwriting compensation shortly before the offering date (Metzger, pp. 113-117; Exh. 6581). The prospectus was amended to provide for a sale of the warrants to the public (*Id.*)[8]

Although strictly prohibited from receiving any Aero Systems warrants as additional compensation, Vigman did so anyway. Vigman distributed the warrants to friends and trusted customers who agreed to sell the warrants back to Vigman at or near their original cost (Vigman, pp. 689-702). Vigman was able to acquire 124 warrants for approximately $10-15 per warrant (Exhs. 6590-6591). At the time that a market for the Aero Systems warrants was established approximately one year later, Vigman sold the warrants through Executive Securities for an astonishing $894,000. (Vigman, p. 730, Exh.

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stock of Franklin Balmar, Inc. during the period from July 1964 to April 1965. Pursuant to this investigation, Vigman agreed to be barred from engaging in the securities business and from associating with any broker-dealers in August 1967 (Exhs. 6567; 6568). Notwithstanding that Holmes was put on notice of this, and clearly understood the potential adverse consequences (not to mention Vigman's questionable character), Holmes continued Aero Systems' initial public offering through Vigman and J.C. Roberts (Holmes, pp. 1185-1190; Exh. 5302).

[8] After Aero Systems' initial public offering, J.C. Roberts made a market in Aero Systems (Vigman, p. 455)

6591). Unfortunately for Vigman, the deception was uncovered and he was indicted for the warrants distribution in the Southern District of Florida (Exh. 6580). Vigman pled *nolo contendere* and was found guilty of 10 counts of securities fraud, but Vigman was fined only $100,000 (Vigman, p. 721; Exh 6585). Thus, Vigman's profit from Aero Systems warrants, *after* the fine, exceeded $790,000.[9]

Before the initial public offering, Holmes participated in a separate deceptive scheme to get Aero Systems shares into the hands of Vigman or those he controlled.[10] At Vigman's recommendation (Holmes, p. 1179), Holmes ostensibly sold 20 shares of stock to Joseph Vigman,[11] and claims to have sold 19.75 share to MHS, Inc. (Holmes, p. 1217, 11. 15 - p. 1218, 1. 13; Exhs. 5294)[12] A subsequent split of 1:800 in Aero Systems stock turned the 20 shares "held" by Joseph Vigman to 16,000 shares and MHS, Inc.'s alleged holdings of 19.75 shares to 15,800 shares. (Holmes, pp. 1220-1221; Exh. 5294). The Aero Systems stock sold to Vigman's brother and MHS, Inc.[13] was

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[9] No direct evidence of Holmes' foreknowledge of Vigman's felony has been established to date. However, because of the "sales" of Aero Systems shares to Joseph Vigman and MHS, Inc., described and because of the relationship of Holmes to Vigman, it could easily be inferred that Holmes knew what Vigman was doing.

[10] Vigman made a habit of having stock he owned and controlled in the names of others.

[11] Joseph Vigman was Vigman's brother (Holmes, p. 1179).

[12] These sales represented 14.79% of Aero Systems' outstanding stock at the time (Exh. 5294).

[13] The address of MHS, Inc. was the same as J.C. Roberts' address (Exh. 5291). MHS, Inc. became a wholly owned subsidiary of Aero Systems (Exh. 5262, at page 12).

purchased for $.50 a share (Exh. 5294); the public offering, only four months later was for $3.00 per share (Exh. 5302)[14] The preliminary prospectus filed on 1-18.67, only two and a half months later, established the $3.00 price per share (Exh. 5290). This represented a huge profit for whoever really purchased the stock at a bargain price.[15]

Despite Holmes' testimony that MHS purchased the stock (Holmes, pp. 1217-1218) and despite the fact that Aero Systems prospectus recited the same (Exh. 5297), Murray H. Silvershein, President of MHS, Inc. denies that the purchase by MHS, Inc. ever took place (Silvershein, pp. 10-11; .56; 58). Also Joseph Vigman recalls *nothing* about the transaction (Joseph Vigman, pp. 43-44).[16]

Vigman admits that he later received MHS, Inc.'s 15,800 shares of Aero Systems stock, but claims to have negotiated a sale of the shares from MHS, Inc. to his wife,

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[14] With J.C. Roberts and Vigman as the market maker, the price of Aero Systems stock went from $3.00 at the "public" offering to $135.00 per share on October 11, 1968. The high bid for that day was 27 and high ask was 27½, but taking into account a 1:5 stock split in November 1967 (Holmes, pp. 2433-2436; Exh. 3932) the original share was worth $135.00 (Exh. 4115).

[15] If sold at the $3.00 offering price, the real owner of the stock would have received $40,00 for 16,000 shares and $39,500 for 15,800 shares.

[16] The prospectuses (Exhs. 5297, 5298, 5300 and 5301) say nothing about Holmes' sale to Joseph Vigman. If indeed the stock went to Seymour Vigman, it should have been disclosed as additional compensation to the underwriter.

Nettie Vigman (Vigman, pp. 834-835; Exh. 6592)[17]. However, Silvershein unequivocally testified that he has never seen the alleged "bill of sale" from MHS, Inc. to Nettie Vigman (Silvershein, p. 61; Exh. 4109). The document, signed by Nettie Vigman, did not have an authentic MHS, Inc. letterhead, and Silvershein testified that nothing ever went out to MHS unless it was under MHS' letterhead, and that he had no knowledge of who generated the "bill of sale," (Silvershein, pp. 58, 61). Silvershein further testified that he never sold stock to Nettie or Seymour Vigman and that he never received any payment from them by cash or check (Silvershein, pp. 58-60).

From the foregoing, it is more than reasonable inference that at least the 15,800 shares of Aero Systems purportedly "sold" by Aero Systems to MHS, Inc. did *not* go to MHS, Inc. as directed in the prospectus, but went directly to Vigman as additional compensation. Thus, Vigman, who had been denied the opportunity by the Florida Securities Commission to obtain additional compensation through the warrants, obtained additional compensation through this deception.[18]

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[17] Vigman maintained complete control over Nettie Vigman's trading and stock interests. He testified that he controls "[a]nything that has to do with stocks or anything that has to do with financial, all her affairs" (Vigman, p. 27).

[18] It is also a fair inference that Holmes participated in the sham. Holmes, prior to the public offering, had owned and controlled all of the stock of the company; would he not be vitally interested in who controlled 14.79% of his stock? Holmes does not recall ever meeting or seeing Joseph Vigman (Holmes, pp. 1223-1224). Vigman was the one who probably

(Continued on following page)

Even assuming MHS was sold the Aero Systems stock as Holmes claimed, Aero Systems failed to disclose to the public that MHS, Inc. received its Aero Systems stock as a "finder's fee-type compensation" (Holmes, pp. 1226-1227; Vigman, pp. 835-836). This fact should have been disclosed in the Aero Systems Prospectus, but was not (Exhs. 5297, 5298, 5300 and 5301).

Prior to his felony conviction in Miami, Florida, Vigman moved to Newport Beach, California. (Vigman, p. 92). Undaunted by the fact that Vigman was barred by the SEC from acting as a broker-dealer and that Vigman was a felon convicted of illegally profiting from Aero Systems securities, Holmes kept in touch with Vigman after the move (Holmes, p. 1193), and continued to use Vigman as a business confidante and financial advisor (Vigman, pp. 199; 205; Holmes, p. 37). By necessary inference, Holmes saw a future of opportunity to profit by Vigman's ingenious stock schemes in the future.

D. LUGO'S CLOSE RELATIONSHIP WITH HOLMES AND VIGMAN

Lugo first met Robert Holmes in connection with the Aero Systems underwriting by J.C. Roberts in 1967 (Holmes, pp. 138: 2584-2585; Lugo, p. 701). Thereafter, Lugo operated the "back office" at Executive Securities

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(Continued from previous page)

recommended to Holmes the sale to Vigman's brother and to Vigman's friend Silvershein. (Holmes, pp. 1179; 1180). Finally, the fact that Joseph Vigman has such a complete lapse of memory leaves his *bona fides* in serious question.

(Winkler, p. 14). While Lugo was involved with Executive Securities, he was disciplined and suspended by the SEC.[19] In 1975, following his suspension, he formed First State Securities Corporation ("FSSC") in Miami, Florida (Exh. 8003). He met with Holmes on May 20, 1976 to discuss "what FSSC can do" for Holmes (Exh. 3950). Holmes opened various accounts at FSSC (Holmes, p. 1551). Holmes referred his mother, father, brother and his two sons to Lugo, who opened accounts for each of them at FSSC (Holmes, pp. 2922, 2921, 2918, 2910, 2903). Holmes' wife Marjorie, also opened an account with Lugo (Holmes, p. 2912). The Holmes and the Lugos met socially on several occasions, beginning in 1974 or 1975 (Holmes, pp. 151; 2426 – 2427).

As a market maker in Aero Systems (Holmes, p. 150), Lugo visited the Aero Systems premises (Holmes, p. 192) and, by 1979-1980 Holmes considered Lugo to be an "expert" in the valuation of Aero Systems stock. (Holmes, pp. 157-159; Exh. 5206). Their close relationship was typified by Holmes' identification of Lugo as "Joey" (Holmes, pp. 138; 153; 2608-2612; Exhs. 5205, 6131, 3952, 3953).

Lugo's relationship with Vigman was just as close. Vigman was Lugo's best man at Lugo's wedding (Vigman, pp. 91-92). Lugo displayed photographs of Vigman

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[19] In connection with the SEC's investigation of Executive Securities and, *inter alia*, the "spin-off" corporations, Lugo was barred from association with any broker-dealer or investment advisor with the exception that after one year he could become associated in a back office capacity and after three years he could become associated in any capacity.

in his den (Garrity, p. 28, 12/16/86), and named Vigman the Godfather of his first child (Vigman, p. 86). Vigman provided Executive Securities and Lugo access to all J.C. Roberts books and records – at no cost (Vigman, pp. 651-652). Lugo assisted Vigman's scheme to profit from Aero Systems warrants, providing the names of Lugo's relatives for use as nominees and later selling the warrants for Vigman through Executive Securities (Vigman, p. 697),[20] and through two banks that dealt with Executive Securities (Vigman, pp. 674-675). Vigman maintained an office on the premises of Executive Securities despite the fact that he lived in California and had been barred by the S.E.C. from associating with any brokerage firm (RFA 608).

E. EXECUTIVE SECURITIES CORPORATION AND NEWPORT SECURITIES

1. Lugo and Executive Securities Corporation Replaced J.C. Roberts.

Immediately after the demise of J.C. Roberts in 1967 there arose in its place -literally – a broker/dealer firm under the name of Executive Securities, founded by former J.C. Roberts employees, Lugo, Elliot Eiseman ("Eiseman") and Hal Winkler (Winkler, pp. 13-14). The firm began doing business in the same offices which had been occupied by J.C. Roberts (Metzger, p. 25) and hired a staff consisting of J.C. Roberts, ex-employees (Winkler, p. 18).

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[20] Vigman testified that Lugo's mother, aunt and uncle were among those who bought and returned warrants to Vigman. Lugo, he said, may even have contacted his relatives for Vigman (Vigman, pp. 697-699).

Executive Securities also maintained a majority of the customer accounts from J.C. Roberts (Winkler, p. 18) and made a market in the same stocks as J.C. Roberts (Metzger, p. 24, 25 and 154 also Winkler, pp. 21-26). As Jordan Metzger, the lawyer for Executive Securities put it, "J.C. Roberts subsequently became Executive Securities." (Metzger, p. 24).

Holmes, involvement with Executive Securities was substantial. Holmes had a personal account there (Holmes, p. 1194; RFA 246) and admits that he may have talked to Vigman about Executive Securities (Holmes, p. 2540-2541). Executive Securities became an Aero Systems market maker immediately after J.C. Roberts was put out of business (Holmes, p. 1191; RFA 242). On February 28, 1968, Holmes sold 25,000 Aero Systems shares to Executive Securities for $3.00 per share. (Holmes, pp. 2444; 2448-2450).[21]

The success of the Aero Systems public offering in March, 1967 was followed in January, 1968 when Executive Securities conducted an initial public offering of its own stock (Exhs. 2549; 6414) and Holmes became a substantial stockholder in the brokerage firm itself (Holmes, pp. 2537-2538; Exh. 3945). Holmes also subscribed to a private placement of Executive Securities in February 1968, a month after the first public offering of the stock (*Id.*).

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[21] On the same day, Holmes sold Nettie Vigman 50,000 shares of Aero Systems stock for $2.00 per share (Holmes, pp. 2441-2443). Holmes had approached Vigman to sell him the stock (*Id.*, p. 2445) and Holmes gave it to him for two dollars per share "[b]ecause I liked him" (*Id.*, p. 2447).

a. The Spin-Off Transactions

Holmes and Vigman "engineered" a series of corporate "spin-off" transactions by which Aero Systems stockholders received as dividends shares of Aero Systems, subsidiary corporations. The result of these spin-off transactions was to create instant public corporations whose stock could be traded in the marketplace (Exh. 6455). The investing public, who were buying these stocks in the marketplace, did not have the benefit of disclosures which would have been required under the Securities Act, and which presumably would have affected their desire to buy, sell or hold the stocks (*Id.*). Because no SEC disclosure filings were made in connection with the spin-off corporations, the prices of the stocks could be set almost arbitrarily by the market makers. Not surprisingly, Executive Securities immediately made a market in the stocks of the spin-off corporations and began trading the stocks to the public. (Metzger, pp. 154; 172-173; Exh. 6455)

Between 1967 and 1969, Aero Systems spun off securities in subsidiary companies, including Aero Tech, Hydro Tech and Micro Tenna Corp (Exh. 6455). In each instance, a public market was instantly created, J.C. Roberts or Executive Securities acted as a market maker (Metzger, p. 154), no registration statement was filed with the SEC, and shares in the newly-traded securities were distributed to Holmes and Vigman in accordance with their stock interests in Aero Systems. (Vigman, p. 505; Exh. 6455).

In his testimony, Vigman admitted that he may have recommended the spin-offs to Holmes, and that he was

involved with the spin-offs (Vigman, pp. 478-481; 497-502; 504-507). He discussed the merits of the spin-offs with Holmes. (Vigman, pp. 478-481). Holmes, likewise, admits that Vigman was involved with the spin-offs, as well as the acquisition of Aero Systems' subsidiary corporations. (Holmes, pp. 1272-73, 3296, 3308.) The flurry of spin-off transactions in the late 1960's included companies other than Aero Systems. Of significance, International Book Corp. spun off its subsidiary, Corporate Enterprises, a company formed upon the recommendation of Vigman. (Holmes, p. 3278; Vigman, p. 500; Exh. 6455).[22] Thereafter, Corporate Enterprises spun-off defendant Bunnington Corporation (Diamond, pp. 47-48; Vigman, p. 501). Holmes purchased Corporate Enterprises stock from a member of the Vigman family (Holmes, p. 3283). Also, because Holmes had purchased Corporate Enterprises stock with money borrowed from Vigman (Holmes, pp. 1276-1277), Holmes received stock in Bunnington. As with the other spin-offs, public trading commenced, no registration statement was filed with the SEC, and the stocks of Corporate Enterprises and Bunnington were placed in the hands of Vigman and Holmes, among others (Exh. 6455).

The rapid succession of spin-off transactions did not go unnoticed by the SEC. A SEC investigation resulted in

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[22] Corporate Enterprises was a company "with no activities" (Blumenthal, p. 25.). Blumenthal, who was President of Corporate Enterprises for a period of time, could not even recall the nature of Corporate Enterprises, business in the 1960's. (Blumenthal, pp. 24-25).

SEC administrative findings in 1972 that Seymour Vigman had violated the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with the spin-off transactions. (*In the Matter of Seymour Vigman*, Exhibit 6579)[23]. In accordance with his consent agreement, Vigman was "barred from being associated with any broker, dealer or investment advisor." (*Id.*) Executive Securities and the principals of Executive Securities also consented to remedial sanctions. (Exh. 6455.) Under the terms of that consent, Executive's registration as a broker/dealer was temporarily suspended, and Joe Lugo was barred from association with any broker/dealer or investment advisor "except that Lugo may after one year become so associated in a 'back office capacity' and after three years from the bar become so associated in any capacity" (*Id*).[24]

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[23] In the findings and order imposing remedial sanctions, it was found that Vigman "offered, sold and delivered common stocks of Aero Tech, Inc., Instrument Technology Corporation, Audio-Visual International Corporation, Hydro Tech Corporation, Micro Tenna Corporation, Plastic Universal, Inc., *Bunnington Corporation*, Resort Car Rental Systems, Inc., *Aero Systems*, Inc., and *Osrow Products, Inc.*, when no registration statement under the Securities Act was filed or in effect as to such securities and, in connection with transactions in such securities, quoted the securities at arbitrary prices and failed to disclose material information concerning the reason for their disposition and the persons in control, business operations and financial condition of the issuers." (Exh. 6579) (emphasis added).

[24] Defendant Martin Blumenthal was also investigated by the SEC and consented to an order barring him "from acting as or being associated with any broker, dealer or investment adviser." (*In the Matter of Martin Blumenthal*, Exh. 4826.)

Despite the sweeping investigation by the SEC concerning the spin-offs, Holmes claims to have only a "vague recollection" that Lugo and Eiseman were accused of distributing unregistered securities in the spin-off corporations. (Holmes, pp. 2577-2578.)

By 1975, Executive Securities had encountered other problems and was liquidated under the authority of the Securities Investor Protection Act (Declaration of John Moelter ¶ 2).

b. Newport Securities

Shortly after Vigman moved to Newport Beach, California in 1968, a brokerage firm named Newport Securities, Inc. commenced operations in Newport Beach, California (Holmes, p. 143). Two of the three founding principals of Newport Securities were Martin Susson and Gurdon Wolfson. Martin Susson was an insurance salesman from Philadelphia with no previous experience in the securities industry (Holmes, p. 1196). More importantly, Susson was also Vigman's brother-in-law, a fact known to Robert Holmes (Holmes, p. 145).

Gurdon Wolfson was the Chief Operating Officer at Newport Securities (Joss, p. 24), having worked previously at both J.C. Roberts and Executive Securities (Holmes, p. 1192; Winkler pp. 177-178). Wolfson, who had been Vigman's neighbor and friend in Florida (Holmes, pp. 144; 1193), became Holmes' personal stock trader at Newport Securities. Holmes did not give any particular reason why he, a Florida resident, opened a securities account with a California brokerage firm (Holmes, pp. 143-145). Of course, Seymour and Nettie Vigman also had

accounts at Newport Securities (Vigman, p. 179). As one would expect, Newport Securities became a market maker in Aero Systems stock (Holmes, pp. 1193-1194).

Although Vigman had been barred from associating with any broker/dealer, he played a role in both the creation and operation of Newport Securities. Vigman testified that Susson and Wolfson met with him "accidentally" in Newport Beach prior to the formation of Newport Securities. (Vigman, pp. 467-468).

Susson stated that Vigman arranged for him to leave the insurance business in Philadelphia to become an owner of Newport Securities (Susson, p. 27-28). Garrity testified that before Newport Securities opened, he met with Vigman at the Doral Hotel in Miami, Florida (Garrity, pp. 8-12, 12/6/86), where Vigman brought up the subject of whether or not Garrity would be interested in joining Newport Securities when it opened (*Id.*, 12/16/86) Garrity, at the time, declined to do so (*Id.*, 12/16/86).

Joss testified that Vigman controlled Newport Securities (Joss, pp. 21-22). Joss further testified that Wolfson had told Joss that Vigman was involved in Newport Securities (*Id.*, p. 22).[25] Joss also attended a meeting with Vigman and Wolfson at Vigman's home at the time that

[25] As described, Wolfson and Vigman were co-conspirators in the manipulation of stock prices in DCS Financial Corporation. Joss' testimony is thus admissable under Federal Rule of Evidence 801.

the SEC ordered Newport Securities to shut down and liquidate its inventory (*Id.*, pp. 24-25). At this meeting, Vigman discussed the stock positions that Newport Securities held in inventory and how they would be liquidated (*Id.*, pp. 25-26).

Joss further testified that there was another meeting that he attended in the early 1970's held in Palm Springs, California, which Vigman, Wolfson, Susson and Garrity attended. (*Id.*, pp. 27-28.)[26]. The purpose of the meeting was to "promote" a stock in which Newport Securities made a market (*Id.*). According to Joss, both Wolfson, who revered Vigman's "genius," and Susson stated that Vigman had the ability to "engineer" corporations, *i.e.*, creating enough of a facade for people to get interested in buying a stock (*Id.*, pp. 49; 59-63). Newport Securities, along with other market makers, would have the ability to raise a stock's price whereas a single broker could not (*Id.*, pp. 59-64).

Thus, Holmes' close friend and advisor Seymour Vigman was, in effect, an insider at Newport Securities, the west coast market maker for Aero Systems. Newport Securities fared no better than Executive Securities in avoiding the scrutiny of the SEC in connection with unlawful trading practices.

[26] Garrity later became a broker at Joseph Sebag, Inc. He was introduced to Joss as an employee of Newport Securities while Joss was visiting the Newport Securities' offices. (Joss, pp. 31-32).

F. THE FSSC – SEBAG RELATIONSHIP

1. The Formation of FSSC

After Executive Securities ceased doing business in 1975, Lugo and Eiseman formed FSSC (Eiseman, p. 100, 5/7/86). At the time, Lugo still had two months left on a SEC suspension from being associated with a broker dealer (Eiseman, p. 102, 5/7/86).

Eiseman and Lugo were the only two shareholders of FSSC (Eiseman, p. 105, 5/7/86). Eiseman was FSSC's President; Lugo was Vice President, Treasurer and financial principal (*Id.*, 5/7/86) He also was in charge of all back office operations, and he also attempted to develop a retail clientele (*Id.*, p. 124, 5/7/86). Lugo was responsible for the preparation of the monthly Focus Report (*Id.*, pp. 126-127, 5/7/86). Although Eiseman signed the monthly Focus Reports as President, he did not review them. In fact, he did not understand the source for the entries made in the reports or understand the calculations contained in the reports (*Id.*, pp. 128-129, 5/7/86).

2. Vigman Introduced Lugo to Garrity

Garrity originally met Lugo while visiting J.C. Roberts & Co. in the late 1960's (Garrity, p. 14, 12/16/86). Vigman reintroduced Garrity and Lugo in 1976 or 1977 (*Id.*, p. 21, 12/16/86) and told Garrity that Lugo had opened FSSC (Garrity, p. 74, 2/29/88). The Lugo-Garrity relationship would continue until the collapse of FSSC and Sebag.

Lugo introduced Garrity to Aero Systems, Aerosonic, Bunnington, Creditbank, Dash and Osrow. Lugo encouraged Garrity to retail the stocks to his customers (Garrity, p. 54, 2/29/88). He provided Garrity with information concerning Aero Systems, Aerosonic, Bunnington, Creditbank, Dash and Osrow (Garrity, p. 53-54, 2/29/88). Lugo called Garrity often at the office and at home (Garrity, p. 68, 2/29/88).

3. Lugo, Garrity and Aero Systems

Garrity first became aware of Aero Systems in the late 1960's (Garrity, p. 183, 3/2/88). Garrity ceased to be interested in the company some time around 1970 because Aero Systems had no earnings (Garrity, pp. 187-188, 3/2/88). He had no interest in Aero Systems again until late 1976 or 1977 when he bought a few shares from Lugo (Garrity, p. 183, 3/2/88).

Garrity became active in Aero Systems again in early 1980 (Garrity, p. 185, 3/2/88). Lugo was a significant factor in Garrity's decision to resume an interest in Aero Systems (Garrity, p. 228-229 3/2/88). During a visit in 1980, Garrity, Lugo and Lewis Leeds[27] met with Holmes at the Aero Systems facility (Holmes, p. 2379). Lugo set up the meeting between Holmes and Garrity (Holmes, p. 2381). Garrity followed most of Lugo's suggestions (Garrity, p. 230, 3/2/88).

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[27] Leeds had been the president of International Book, one of the spin-off companies that Vigman brought public in the 60's. Leeds later opened his own stock brokerage firm (Garrity, pp. 230-232, 3/2/88).

Prior to the announcement of the acquisition of the CD-3000 in April 1980, Garrity was led to believe that there was going to be an announcement that would be exciting with the investment community and "make the stock go up." (Garrity, pp. 210-211, 230-231, 3/2/88). After the announcement, and when Garrity began retailing the Aero Systems stock, he repeatedly told his customers about the CD-3000 (Garrity, p. 194, 3/2/88).[28] Garrity heard "grand and wonderful things" from Lugo and Vigman with respect to Aero Systems selling fuel management systems (Garrity, p. 36, 12/16/86).

From early 1980 through July of 1981, Aero Systems was "highly liquid" as a result of numerous announcements about the CD-3000 (Garrity, pp. 33-35, 3/1/88). There was a lot of buying activity and Garrity built up a position in the stock (Garrity, pp. 33-35, 3/1/88).

In 1980-81, Garrity liquidated his position in Aero Systems into the market created by Robertson Securities purchasing the stock (Garrity, pp. 190-191, 3/2/88).

4. Lugo, Garrity and Bunnington

Another of the companies that Lugo introduced Garrity to was Bunnington (Garrity, p. 84, 2/29/88). Garrity caused Sebag to make a market in Bunnington (Garrity, pp. 52-53, 2/29/88).

In the later part of 1976 and early 1977 Vigman, Blume' ıal, Speyer[29] and acquaintances of Vigman began

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[28] Sebag was a market maker for Aero Systems at all times between February, 1980 and July, 1981 (RFA 921).

[29] Ron Speyer is Vigman's son-in-law (Vigman, p. 13).

to trade the stock of Bunnington through accounts at FSSC (Eiseman, p. 342-367). During that time period, Vigman related entities purchased or sold 152,000 shares of stock (Exhs. 6625, 6626).

Due to the questionable nature of the purchases and sales of Bunnington stock through FSSC, the trading of Bunnington was investigated by the NASD (Eiseman, pp. 342-367, 5/8/86). Based upon the NASD investigation, a disciplinary action was instituted against Lugo alleging that he manipulated the price of the Bunnington stock (Eiseman, p. 345). Lugo was censured and fined (*Id.*, p. 365, 5/18/86).

G. THIS RISE AND FALL OF DCS FINANCIAL CORPORATION

Vigman and Diamond incorporated DCS Financial Corporation ("DCS") in June, 1972 by Vigman and Diamond with a $500,000 investment from Vigman and a $500,000 senior subordinated convertible debenture purchased by Nettie Vigman (Diamond, p. 92; Exhs. 2835 and 6593). Diamond later purchased 160,000 shares of DCS on August 29, 1972 (Diamond, pp. 103; Exh. 6593). In addition, Blumenthal also purchased 20,000 of DCS on the same date (Exhs. 2836; 6593).

In a complex transaction in September 1972, DCS merged with El Chem Machinery and, through a subsequent plan of reorganization, El Chem's public shares were reduced through a 1-for-7 reverse split. El Chem issued 700,000 new shares, of which Vigman ultimately controlled 500,000 shares. (Exhs. 2837, 2852). At the completion of this reorganization, Vigman and Diamond

became the two largest shareholders (Diamond, p. 126). The reorganization also created a public market for DCS and eliminated the company known as El Chem Machinery, Inc.

Vigman, Diamond and Gerald Fincke, a lawyer, were the only members of the Board of Directors of DCS (Exh. 1059 at p. 13). Once Vigman and Diamond gained control of DCS, and it became a publicly traded company, its stock price rose dramatically. In less than 3 months, the stock price rose from 25 cents bid/50 cents ask ($1.75 and $3.50 adjusted for the reverse split) to $39 bid/$41 ask (Exh. 2852). Newport Securities was the principal market maker for the DCS stock during this period (Combs, p. 24).

Once again, the SEC began to investigate and, on November 29, 1972, issued an order stopping the public trading in DCS stock (Vigman, p. 897; Exh. 8000). The SEC thereafter brought a civil action against Newport Securities, its principals, DCS, Vigman and Diamond (Exh. 2852). Prior to trial, Vigman entered into his third consent agreement with the government, this time enjoining him from engaging in fraud in the purchase or sale of securities. (Vigman, p. 897) After a trial in 1973 before the United States District Court for the Central District of California, Judge W. Matthew Byrne, Jr. entered findings of fact supporting the issuance of a permanent injunction against DCS, enjoining it from further violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exhs. 2852; 5406).

Although the SEC's stop trade order was subsequently lifted, the permanent injunction had a substantial

impact on the ability of DCS stock to be traded and for DCS to find market makers (Diamond, pp. 238-39). The price of DCS stock dropped very dramatically after the SEC trading ban went into effect (Diamond, p. 1071) and, despite the fact that Diamond and Fincke persuaded Vigman to resign as an officer and director of DCS (Fincke, pp. 74-75),[30] DCS stock prices languished and there was virtually no public market for the DCS stock after the 1973 injunction (Diamond, pp. 1071-72).[31]

At first, Diamond and McNeil considered having Bunnington purchase DCS in order for Bunnington to acquire Springwater as an asset (Fincke, p. 82). McNeil wanted Bunnington to own Springwater very much

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[30] Gerald Fincke, the lawyer for DCS testified that the principals of DCS wanted to get rid of the company in a two step process. First, Fincke recommended that the principals (*i.e.*, Diamond, McNeil and Fincke) get rid of Vigman in an attempt to make DCS a "financially real public company" because Vigman's reputation with respect to securities matters was so bad (Fincke, pp. 74-75). Fincke testified that "the obvious manipulation of DCS' stock" while Vigman was in control just added to it (*Id*). Fincke did not believe that anybody would treat it as a real company as long as Vigman was associated with it (*Id*). Thus, he and Diamond persuaded Vigman to resign from DCS (*Id*). Second, Fincke and Diamond realized that the company was winding down, served no purpose because of financial reasons and had a large net operating loss carry forward. (*Id*).

[31] Vigman supposedly "sold" his DCS stock in August 1973 to Nettie Vigman, Speyer, Diamond and Arvin Grossman. The "sale" to Speyer was a sham. Also McNeil testified that he purchased 40,000 shares of DCS from Vigman in 1974 at $.25 a share (McNeil, pp. 47-53; 59-61).

(*Id.*).[32] However, they learned that there was no way to structure the transaction by which Bunnington could obtain DCS's operating loss carry forward because of the common control situation with Diamond's positions in both Bunnington and DCS (Fincke, p. 80).

Being unable to acquire the company they wanted "very much," Holmes, Vigman, Diamond and McNeil developed a much more profitable plan that gained them Springwater and valuable Aero Systems stock.

H. DCS MERGED WITH AERO SYSTEMS

Holmes, Vigman, Diamond and McNeil conceived and executed a scheme to get tradeable Aero Systems securities in the hands of DCS shareholders and to get Springwater, DCS, only viable asset,[33] back to Bunnington. Vigman, not DCS officers Diamond or McNeil, initiated merger discussions with Holmes in 1976 by which DCS would be acquired by Aero Systems (Holmes, p. 1381, Vigman, pp. 286; 291; 771).[34]

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[32] Diamond, President and Chairman of the Board of Bunnington, was responsible for managing Springwater's operations (Holmes, p. 170).

[33] Exh. 5308, pp. 001-12225 and 001-12252

[34] At the time the negotiations commenced with Holmes in 1976, Vigman was not on Bunnington's Board of Directors, nor was Vigman a large shareholder of Bunnington (Holmes, p. 1272). Shortly after the merger, Vigman became a substantial shareholder of Bunnington, and then Springwater was sold back to Bunnington by Holmes. Vigman eventually not only had valuable Aero Systems stock but also control over Springwater, the only viable element of DCS the ruination over which he had presided.

Holmes discussed the terms of the merger with Vigman (Holmes, p. 2941; Exh. 4049; Diamond, p. 298) and "kicked . . . around" the exchange of DCS stock for Aero Systems stock (Vigman, p. 291), the consideration for the merger (Vigman, p. 796), and participated in the negotiations regarding the merger (Vigman, p. 752). Vigman also discussed the proposed merger with Diamond and McNeil after his initial discussion with Holmes (Vigman, pp. 775; 786). Holmes asked Lugo to render an opinion as to the value of the Aero Systems stock and FSSC did so (RFA 843).

Tom Huston, Vigman's personal accountant and the accountant for J.C. Roberts[35] told Holmes before the merger that the IRS would disallow DCS' loss carry forward if the principal purpose of the acquisition was the reduction in income tax and that the companies should " . . . well document the business reasons for the transaction and that you be aware that the Internal Revenue Service has this very potent weapon if it challenges the use of the loss carryover" (Exh. 5314)

Aero Systems and DCS followed Mr. Huston's advice. They each prepared a list of "reasons" for the merger (Exhs. 5315, 5317). Conspicuously absent from either list was the use of the tax loss carry forward. Yet Diamond admits that Holmes, and Aero Systems' reason for the DCS merger was because Aero Systems had the ability to use the tax loss carry forward that DCS brought

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[35] Vigman referred Huston to Holmes (Vigman, p. 782). He also referred Huston to Diamond (Vigman, p. 783).

with it (Diamond, p. 1075). This reason for the merger remained undisclosed to the public or the IRS.

On the other hand, 18 of the DCS shareholders had compelling reasons to accomplish the merger (Exh. 5315); they would receive restricted but eventually tradeable, Aero Systems stock for their DCS stock (Diamond, p. 1072).[36]

Since at the time of the merger there was very little trading in DCS stock (Diamond, p. 1071;) DCS pronounced what was the single, true and only reason for the merger. In its Information Statement Concerning Special Meeting of Shareholders of DCS Financial Corporation held on June 27, 1976 it said:

> "Secondly, for the past three years there has been no public market for the Company's Common Stock; therefore the merger will enable all shareholders owning what is theoretically, but not in actuality, freely tradable stock to receive cash for an illiquid investment considerably in excess of (4 1/2 times) its book value."

The Statement continued:

> " . . . [o]n the other hand, even though these shareholders will receive in the merger

[36] The merger agreement was signed on July 22, 1976 (Exh. 1066). It was between DCS and Aero Systems Avionics, Inc., a wholly owned subsidiary of Aero Systems (RFA 125). The terms of the merger included, *inter alia*, that Avionics would acquire all of the DCS common stock in exchange for 939,461 shares of Aero Systems common stock and $32,000 in cash (RFA 147). Holmes and Diamond structured the deal so that only 18 "major" shareholders received Aero Systems stock for their holdings in DCS while the other 377 shareholders only received the $32,000 cash (Exh. 5315).

> restricted Aero shares which will not be saleable to the public for at least two years, they will nevertheless own stock in a profitable publicly traded company which, if they so desire, may in the future be sold in the public market pursuant to Rule 144." (Diamond, p. 1063; Exh. 5315)[37]

At the time of the merger in 1976, the following were among the DCS shareholders who would receive Aero Systems stock: Nettie Vigman – 106,925 shares[38] Speyer – 106,925 shares,[39] Diamond – 595,289 shares and Blumenthal – 24,863 shares (Diamond, pp. 1076-1077; Exh. 5316).

Diamond, the Chairman of DCS at the time of the merger (Diamond, p. 1063) acknowledged that the exchange of untradable stock for tradable stock (after a holding period of two years) was a benefit to him and he did consider this fact in deciding whether or not to sell DCS to Aero Systems (Diamond, p. 938).

[37] This statement was distributed to DCS shareholders concerning the merger (Diamond, p. 1065).

[38] Nettie Vigman is Vigman's wife and Diamond's sister (Diamond, p. 1007). Vigman has admitted that his wife knows nothing about any of the stock transactions and that he controlled all of the stock in her name (Vigman, p. 27).

[39] Vigman claims that Speyer bought 90,000 shares of DCS stock from Vigman in 1973 for $104,000 (Vigman, p. 13). Speyer sold 50,000 shares of Aero Systems stock in September, 1980 (Exh. 9001) (after the manipulation had caused a rise in the stock price) and Vigman claims to have split the proceeds among Vigman's four children (Speyer, p. 14; Vigman, p. 17). However, in truth all but $44,125 of the $237,500 was deposited – under Vigman's handwritten endorsements – to Nettie Vigman's account in November, 1980 (Vigman, pp. 20-25; Exhs. 9007-9009).

Before the merger, Holmes knew that Diamond was the largest single shareholder of DCS[40] and that Diamond's son would also receive 24,440 shares in the merger (Holmes, 2959-2960; Exh. 5316). Indeed, Holmes knew that Diamond would own approximately 12% of Aero Systems stock in the event that the merger went through (Holmes, pp. 3025-3033; Exh. 5316), and that Blumenthal would receive 24,863 shares (Holmes, p. 1470; Exh. 5316). Holmes knew Nettie Vigman had DCS stock at the time of the merger (Holmes, pp. 1443-1446).

Significantly, Aero Systems' Notice of Annual Meeting of Shareholders with Proxy Statement dated and mailed July 2, 1976 (Exh. 4075) relating to shareholder approval of the merger did not mention the fact that Vigman, or Nettie Vigman, or any of Vigman's family, including Speyer, would end up owning Aero Systems stock if the merger was approved by the shareholders. Yet Holmes admitted that he knew that to the extent that the merger agreement called for Aero Systems shares to be issued to the Vigmans, they would end up with a substantial portion of Aero Systems (Holmes, pp. 3025-3032). Vigman, through his wife Nettie and other family members he controlled, together with Diamond and his son, ended up with 17% of the company (Holmes, pp. 3030-3036).

Holmes, following Huston's advice, extolled to his public the "business" benefits that justified the merger

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[40] Diamond owned 55% (Exh. 5315; RFA 818). He voted all of his stock in favor of the merger (RFA 820).

(Exh. 5317)[41] But despite his public posture, Holmes *failed to disclose* that he had *no interest in keeping Springwater* (Diamond, pp. 1074-1075).[42] This fact supports the clear inference that Holmes' motives, and those of his co-conspirators, were not just to sell DCS to Aero Systems.

After the merger, rather than take an active role in the management of Aero Systems's new acquisition, Holmes left the responsibility to Diamond (Holmes, pp. 170; 215). Further, after the merger, Diamond became a director of Aero Systems in July 1976, Treasurer of Aero Systems in August 1976, a director of Aero Systems Avionics Corp. (an Aero Systems subsidiary), President of

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[41] It stretches logic to believe, in the first instance, that a Miami, Florida airplane "junk dealer" would be interested in a Rochester, New York machine shop; no common product, no relationship of product or business.

[42] This publicly undisclosed disinterest is clearly supported by the fact that only eleven months after the "merger" was completed in July 1976 (Exh. 5325), Holmes and Diamond approached the Southeast Bank (which held Aero Systems' line of credit) in June, 1977 to get the bank to waive its security agreement and allow Aero Systems to sell Springwater assets to Bunnington (Holmes, p. 1601; Exh. 5333) However, Southeast Bank would not waive its security agreement or permit the sale to take place (Holmes, 1601; Exh. 5333). Springwater was making money for Aero Systems that year. Springwater generated more earnings than the balance of Aero Systems (Holmes, p. 1601). Since one of the "business" reasons for the merger Holmes told his public was that it would add to Aero systems' profit picture, why sell it at all? Indeed, the fact that Holmes sold it, and the timing, strongly infers an understood pre-arrangement to get it back – in the hands of those at Bunnington who wanted it originally but couldn't have it.

DCS, Chairman of Springwater and Chairman of Bunnington (Holmes, pp. 1490-1491, 1497, 3118; Exh. 4092; RFAs 311, 325, 328, 876, 881, 882). In addition to these rather comprehensive ties between Holmes and Diamond, Holmes also gave Diamond a "consulting agreement" with Aero Systems which Holmes believes was signed shortly after the merger (Holmes, pp. 1610-1612; Exh. 4098).

I. VIGMAN'S ENTRY INTO BUNNINGTON

Once Vigman and Diamond had successfully rid themselves of the worthless DCS stock, obtained a substantial interest in Aero Systems stock and put the only profitable DCS asset, Springwater, into the hands of their good friend Holmes (with the understanding that Bunnington would get it back), Vigman dramatically entered Bunnington Corporation.

In May 1977, Vigman sold 160 acres of land in California to Bunnington for 405,084 shares of Bunnington stock (Exh. 7301). By virtue of this, Vigman became the largest Bunnington shareholder, a director of Bunnington and served as chairman of Bunnington's Executive Committee (Exh. 1572). Before Vigman bought his Bunnington stock, Diamond and McNeil eagerly wanted Vigman to join them and discussed various alternatives of getting Vigman to join them. (Exh. 1574).[43]

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[43] Of course, this eagerness does not square with Fincke's and Diamond's expressed reservations about Vigman's "bad reputation" and his connection with DCS. It strongly infers

(Continued on following page)

J. SPRINGWATER WAS SOLD BACK TO BUNNINGTON

1. Vigman, McNeil and Diamond Finally Reacquired Springwater Through Bunnington Which They Could Not Do Through DCS

Now that Vigman had become a substantial shareholder of Bunnington, the final phase of the DCS/Aero Systems merger was played out. Springwater found its way back to Messrs. Vigman, Diamond and McNeil under Bunnington's roof – a result they could not have achieved without Mr. Holmes and Aero Systems.

During the time that Springwater was "owned" by Aero Systems, Diamond was an Aero Systems officer and Board member (Diamond, p. 303) and received financial information concerning Springwater (Diamond, pp. 312-313). Also, Diamond ran Springwater on a day to day basis after the merger (McNeil, p. 1108). Diamond, in addition to sitting on Aero Systems's Board and being Aero Systems's Treasurer, served as a consultant regarding Springwater (Holmes, p. 170) assisted Aero Systems in obtaining loans from banks (Holmes, pp. 170; 214; 1498-1502), obtained financing for Springwater from two Rochester Banks (Holmes, p. 214) and served as "Special Assistant to the President/Financial Planning" regarding Aero Systems (Holmes, pp. 171-173; Exh. 5207).

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that Diamond and McNeil's efforts to have Vigman "resign" from DCS was so that potential purchasers of DCS, such as Holmes, would not have to disclose Vigman's association with DCS to his shareholders.

After the merger, McNeil, who was the President of Bunnington Corporation and served on its Board of Directors (Exh. 1572 on p. 03633, 1591), was also on the Board of Directors of Springwater (McNeil, p. 1093).

After the abortive attempt by Bunnington to get Springwater back to the fold in 1977, efforts were renewed in early 1978. (McNeil, p. 289). Vigman admits that he "probably" participated in discussions with McNeil, Diamond and Holmes regarding the purchase price of Springwater by Bunnington (Vigman, pp. 795-796). Holmes admits it is more than likely "he discussed it with Vigman." (Holmes, p. 1590-1591) McNeil negotiated on behalf of Bunnington, and he made the details of the "negotiations" known to Vigman and Diamond (Diamond, p. 308; McNeil, p. 290)[44]

Effective March 1, 1978 Springwater's net assets were sold to Honeoye Industries, Inc., a wholly owned subsidiary of Bunnington (RFAs 150, 151; Exh. 1068)

Bunnington's press release concerning the sale was brief (McNeil, pp. 350-351; Exh. 1593). Both the press release and Bunnington's letter to its shareholders (Exh. 1592) did not disclose the obvious conflicts of interest

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[44] In a memorandum from Diamond to Vigman dated May 19, 1977 (Exhibit 2862) regarding what had to be done to accomplish the Springwater to Bunnington transaction, Diamond wrote "Aero Systems has to provide absolute minimum." Diamond testified that it may have meant in terms of cost of preparation (Diamond, pp. 314-315). It is also consistent with Holmes and Aero Systems already having done enough as accomplices to complete the plan of getting tradable stock into the hands of Vigman and his compatriots, and Springwater back to them.

which existed by virtue of the multiple roles played by Diamond and McNeil both as officers and directors of the acquired and acquiring companies and Aero Systems, nor did it describe Diamond's and McNeil's roles in the "negotiations," nor Diamond's extensive shareholdings in Aero Systems. It didn't even disclose the company from which Bunnington purchased Springwater (*Id.*). Diamond testified that there was never any consideration given to the type of reporting that would be required to shareholders and to agencies about the inter-corporate relationships (Diamond, p. 286). This is despite the fact that the direct question of conflict of interest had been raised by Diamond's bankers in 1977 (Diamond, pp. 1075-1076). Diamond claims that the question was resolved by advice of counsel (*Id.*), but McNeil says he didn't discuss the conflict with Fincke, the company's attorney (McNeil, p. 352). Fincke himself recalls no discussion regarding the need to disclose the conflicts or from what company Bunnington purchased Springwater (Fincke, pp. 206-207; 209; Exh. 1501).

Perhaps the best reason for Bunnington's cryptic notice to shareholders was given by the attorney, Fincke. He said that if Bunnington had revealed who the seller of Springwater was, Bunnington could not have stopped there, but would have to go back to DCS and go back to Vigman to get into the whole relationship (Fincke, pp. 210-211). Of Course, that's the last thing that Holmes, Vigman, Diamond and McNeil wanted to do.

Holmes' accommodation of his friends at Bunnington doesn't stop simply with the retransfer of Springwater into their hands. The terms by which it is done reveal that Bunnington off-loaded California Leisure Corporation

stock, a Bunnington subsidiary, onto Holmes and Aero Systems as a major part of the Springwater/Bunnington deal.

The sale of Springwater to Bunnington was ostensibly for $600,000. (Holmes, pp. 2961-2964; Exh. 4055). $250,000 in cash was paid by Bunnington and Bunnington signed a note to Aero Systems for $350,000 (*Id.*). The note was secured by California Leisure Products stock (*Id.*)[45] One payment of $50,000 was made against the note leaving a balance of $300,000 owed by Bunnington to Aero Systems (Exh. 8002 on 446-15408). Then, in October, 1978 Holmes purchased from Bunnington 47,500 shares of California Leisure Products for $1.00 per share (Holmes, pp. 2215-2216; Exhs. 3896 and 3897), and he had Aero Systems buy 110,000 shares of the same stock from Bunnington at the same price (Holmes, p. 2217-2218).[46] Bunnington intended to use the monies it received from Holmes and Aero Systems to partially pay off the installment contract with Aero Systems for the sale of Springwater, and Holmes knew it (RFAs 807, 825).

Thus, Holmes had Aero Systems accept $300,000 cash for Springwater and then paid Bunnington $157,500 of

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[45] Bunnington owned 86% of California Leisure at the time (Holmes, p. 1607-1608; Exh. 5334).

[46] Holmes became President or Chairman of California Leisure (Holmes, p. 2662) and discussed it with Vigman before he did so (Holmes, p. 2679). Although Holmes claims he'd had no prior dealings with Vigman's son-in-law, Ronald Speyer (Holmes, p. 2678), Holmes asked Speyer to be on California Leisure's Board of Directors (Holmes, p. 2676-2677). California Leisure was not much of an "investment" for Aero Systems shareholders. Aero Systems had to write down Aero System's investment in it (Holmes, p. 2681).

capital by buying the very California Leisure stock (or its equivalent) that secured the debt and allowing Bunnington to "pay" more than half of the existing debt to him and Aero Systems.

Since the valuable Aero Systems' stock was restricted, the DCS players had to wait at least two years before they could begin selling it.

K. THE CD-3000 WAS USED BY HOLMES, VIGMAN AND OTHERS BY USE OF FALSE STATEMENTS, TO CREATE INVESTOR INTEREST IN AERO SYSTEMS

The DCS players had had to wait at least two years to have realistically marketable Aero Systems stock. Aero Systems stock bumped along at an average of $1.34/bid/$1.50 ask in 1977, $3.59 bid/$3.75 ask in 1978 and $2.70 bid/$3.08 ask in 1979. (Foley Decl. ¶133)

1. Aero Systems Acquired the "World Wide Marketing Rights" to the CD-3000

The CD-3000 "Fuel Management Computer" was designed as a "pilot aid" (Hayden, pp. 17-18) for general aviation aircraft operators (*e.g.*, twin Cessnas, commuter planes, etc) (Hayden, p. 21). The CD-3000 was not originally designed as a fuel savings device (Hayden, p. 134), despite the fact that Holmes built an advertising campaign around the device as a system for saving fuel (Hayden, p. 136).[47] In fact, the CD-3000 displays gross

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[47] Hayden thought of the device more of a range extender than as a fuel savings device (Hayden, pp. 134-135). Thus, the CD-3000 wasn't "designed" to "save fuel" as Holmes claimed later.

aircraft weight, fuel remaining, and is not a "computer" in any real sense. The CD-3000 is no more useful for fuel saving than an aircraft manufacturer's performance chart (Davies, pp. 149-150).[48]

Holmes claims that he first heard about the CD-3000 from Charles Hayden ("Hayden") of Colt Electronics, Inc. ("Colt") in February or March 1980 (Holmes, pp. 10-12).

Holmes had a "personal desire" to do something with the CD-3000 (Holmes, pp. 29-30).[49] Vigman shared Holmes' enthusiasm for the CD-3000 (Holmes, p. 31). Holmes discussed with Vigman the possibility of merger between Aero Systems and Colt (Holmes, p. 16). However, Vigman advised Holmes not to buy Colt, but to purchase the rights to the CD-3000 instead (Holmes, p. 30).

Holmes made a trip to Colt in March 1980 (Holmes, pp. 16-17), and told Vigman he was going (Vigman, p. 424).

Robert Lynn, President of Colt, went to Florida after Holmes "invited him to come down" to "discuss some things that might be of interest" (Lynn, pp. 69-70). On March 26th, 1980, the day Lynn arrived in Miami, Holmes showed him around the Aero Systems premises (Holmes,

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[48] Continental Airlines' pilots rejected the CD-3000 since "the computer wasn't doing anything different than what one of the flight crew members would do with a calculator" (Kightlinger, pp. 29-30).

[49] It is the opinion of John Torkelsen, one of plaintiffs' experts, that the stock of Aero Systems was manipulated (Torkelsen Decl. ¶16).

p. 34; Lynn, pp. 71-72; p. 87). The following morning, Holmes took Lynn to Vigman's apartment (Lynn, pp. 70-72; 85-86). Vigman knew Holmes wanted Lynn to meet Vigman (Vigman, p. 423). Prior to this meeting, Holmes had mentioned the CD-3000 to Vigman (Vigman, p. 423). Holmes introduced Vigman as "one of his advisors or something." (Lynn, p. 70). Holmes and Vigman told Lynn about their long term relationship, and Vigman acted as a character witness for Holmes (Lynn, pp. 79-80). They described to Lynn how completely they trusted each other (*Id.*). Subsequent to this meeting, Holmes notified Vigman that Holmes had made the deal with Colt for the marketing rights to the CD-3000 (Vigman, p. 455).

On March 27, 1980, before Lynn left Miami, Holmes signed a letter of intent between Aero Systems and Colt regarding the CD-3000 (Lynn, pp. 85-86; Holmes, p. 40; Exh. 5201). On April 22, 1980 a definite agreement was signed between the two companies (Holmes, pp. 91-92; Exh. 5202).[50]

2. The proper market for the CD-3000 was limited to business jets

The CD-3000 was the idea and invention of Hayden, employed by Colt (Hayden, p. 17). Hayden was an experienced business jet pilot and had a lengthy history in the aircraft industry (*Id.*, pp. 11-18). He had been a member

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[50] Colt extended the original exclusive agreement through 1986, and he "thinks" for an additional two years in 1986. Colt didn't renew the agreement thereafter (Holmes, pp. 3062-3066; Exh. 4082).

of the National Business Aircraft Association since its inception in 1949 (*Id.*, p. 261).

Hayden handled the marketing for Colt (*Id.*, pp. 137-138). He believed the market for the CD-3000 would be small (*Id.*). He believed that the market was very limited for other than business jets (*Id.*, p. 69). Further, Hayden believed the CD-3000 was not of practical use in the general aviation field (*Id.*, p. 69).[51] Hayden was aiming at the business aircraft market (*Id.*, pp. 21-22). He wanted to keep the price low enough to attract commuter aircraft and he did not believe that the CD-3000 would ever be a seller in the airline market (*Id.*). He did not pursue the airline market because he saw no potential for sales in it (*Id.*, pp. 139-142). He had looked at the airlines and found a complete lack of interest (*Id.*). He had conducted market studies by conversing with pilots from all over the world (*Id.*, p. 52). Hayden estimated that Colt would get CD-3000 sales involving 10% of the existing executive aircraft in operation, and approximately 25% of the new executive type aircraft being sold (*Id.*, pp. 53-54). The estimate was based on his examination of the market and of the planes in the market (*Id.*). He estimated that sales would be 35-50 per year (*Id.*).[52]

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[51] The term "general aviation aircraft" refers generally to all aircraft other than commercial aircraft. (*See* Hayden, p. 69).

[52] Hayden's forecasting proved both right and wrong. First, he was right about the market; only 7 were sold by Holmes to airlines between April 1980 and December 1987 and *none* were sold to general aviation aircraft (Exh. 5285). Hayden was wrong, however, about how many would be sold. In eight years, Aero System sold only *90* CD-3000s, which is only a little over *11* per year – less than one a month (Exh. 5284).

Holmes told Hayden how much he wanted to market the CD-3000 under the Aero System's name (*Id.*, p. 61), and that Holmes had expressed that he thought it "would be a great thing for the airlines" (*Id.*, p. 64).[53] However, Hayden told Holmes before Holmes acquired the rights to the CD-3000 that he (Hayden) did not think it would ever be a big seller (*Id.*, p. 137). Hayden expressed extreme skepticism about the arrangement (*Id.*, pp. 61-62). Hayden told Holmes in 1980 that Airlines' maximum efficiency occurs at between Mach .74 and .76 but that airlines operate between Mach .80 and .82 despite fuel considerations (*Id.*, p. 144). Hayden told Holmes that airlines know how to save fuel but don't because of time constraints and that sales to airlines "was a complete and total dead issue." (*Id.*, p. 144; 267-268).[54] Also, Lynn told Holmes that the application of the CD-3000 was limited to business jets, and was only "remotely" applicable to commercial aircraft (Lynn, p. 91). When Holmes sensed Hayden's unenthusiastic reception, Holmes offered Hayden 5,000 shares of Aero Systems stock "if you don't raise too much fuss with Bob (Lynn) to go ahead with this." (Hayden, p. 62)[55].

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[53] Holmes admits that before he signed the agreement with Colt, no CD-3000 had been sold to any commercial airline (RFA 260).

[54] Holmes admits that Hayden "may" have told Holmes that the commercial airlines were not the proper market for the CD-3000 (Holmes, p. 284). Holmes admitted that international airlines were his principal target (Holmes, p. 113). He also admitted that he knew that the device could not be sold to single engine planes (Holmes, pp. 85-86).

[55] While Aero Systems' files are replete with "incentives" or "inducements" to airlines to buy or test the device (facts

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Aside from the idea of selling to the airlines, Holmes never expressed a marketing concept to Hayden except that Holmes intended to sell through dealers (*Id.*, pp. 69-70).

Indeed, before Holmes acquired the "worldwide distribution rights" to the CD-3000 he had had no market study done (Holmes, p. 43).[56] Holmes could have cared less; the real reason that Holmes wanted the rights to the CD-3000 was best expressed by Holmes to Hayden when Holmes was trying to induce Hayden to accept 5,000 Aero Systems shares for not raising a "fuss": "Mr. Holmes expressed to me that, *when he made his pitch with all his people, that the stock would go up sharply*" (Hayden, pp. 179-180) (emphasis added).

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which are too numerous to detail here, but facts with which Aero Systems will not disagree), the bribe to Hayden is only one of two actual known bribes made by Holmes in his desperate efforts to sell the CD-3000 to an airline. In the late spring of 1982, Holmes attempted to bribe Frederick Lind, the Vice President of Engineering and Quality Assurance of Continental Airlines, to enter into "a joint advertising campaign" (Lind Declaration). While this occurred after collapse of the brokerage houses, it is compelling evidence to show that the airlines had not been the proper market, and that Holmes knew it.

[56] Holmes testified that he didn't need a market survey (Holmes, p. 2077). He should have done one, a point that is made quite clearly by Robert Litle, "Special Representative, Aero Systems Aviation Corp" in his memorandum to Holmes dated August 21, 1981 (Exh. 3869). Litle told Holmes that he has "continued my market analysis of airline customers" and that, while the survey "is not yet complete" fully 65% out of 407 aircraft "cannot be fitted with the CD-3000 at this time" (*Id.*). Litle joined Aero Systems on June 21, 1981 (Exh. 8005); was with Aero Systems for two years and his title was approved by Aero Systems (Holmes, p. 2082).

Holmes, however, didn't listen, didn't investigate the market and didn't care what the inventor knew the market for the CD-3000 to be. He had a different agenda.

3. Holmes, Vigman and Others Started to Make the "Pitch" and Misrepresented the Capabilities and the Market of the CD-3000

a. Holmes and Vigman Immediately Began Selling the Device to the Stock Market: They Used Porter LeVay & Rose

Rather than immediately investigate the market for the CD-3000 because of Hayden's caution, or even try to sell the device to the airlines, Holmes and Vigman immediately set out to "sell" the CD-3000 to the stock market.

Holmes first met Mike Porter of Porter, LeVay & Rose ("PLR")[57] sometime between November-December 1979 and January 1980 (Porter, p. 10). Aero Systems retained PLR in or about February, 1980 (Porter, p. 10,) for the express purpose of getting publicity for Aero Systems and its stock (Holmes, p. 634).

Porter was told by Holmes in early 1980 that Holmes was pursuing some new product which Holmes didn't identify (Porter, p. 22).

Holmes called Porter on March 25 or 26, 1980 and told Porter that Holmes had "finalized what they were talking about," that they had acquired "a new product" and wanted "to do a big publicity campaign and really get the story out about this new product because it was

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[57] Porter, LeVay & Rose is a financial public relations firm (Porter, pp. 6-7).

going to bring in millions and millions of dollars of sales to the company" (Porter, p. 32). Holmes asked Porter to fly to Miami right away and Porter did so on March 27, 1980 (*Id.*).[58]

When Porter met Holmes in Miami, Holmes wanted to give Porter "input for the press release" which Porter was to take back to New York and draft (Porter, p. 33). During his discussions with Porter, Holmes kept describing the "millions and millions of dollars that this was going to make and the profits that this was going to give the company and that every single commercial plane in America needed it and so do most general aviation aircraft . . . " and that Holmes "felt the *financial community would go absolutely crazy over this*" (Porter, p. 35) (emphasis added).

After the first meeting with Holmes at Aero Systems' premises, Porter was driven by Holmes to "Vigman's condo" in the Ft. Lauderdale area (Porter, pp. 32-34). On arriving at Vigman's condo, Holmes introduced Vigman as Holmes' "financial consultant, best friend and (as a) *director* . . . [o]f Aero Systems" (*Id.*, p. 35-36) (emphasis added). Vigman didn't deny it (*Id.*). Vigman took control of the meeting "as if Vigman was the resident genius" (*Id.*). Vigman told Porter that he, Vigman, was "Bob Holmes' confidant, if you will, and that Bob (Holmes) would not make a decision without first talking to Vigman" (*Id.*, p. 36). Vigman also warned Porter that he,

[58] This is the same day that Lynn was in Miami and signed the letter of intent.

Vigman, "was chairman of the Bunnington Corporation . . . ," that "he had hired PR firms before" and that "he (Vigman) knew (Porter's) business" (*Id.*, pp. 36-37).[59]

The meeting with Vigman and Holmes took an hour and a half to two hours (*Id.*, pp. 38-39). The three discussed PLR's distribution procedure and what PLR was going to do with the press release (*Id.*, p. 38). While Holmes did contribute to the conversation, Holmes sat back and mostly listened to Vigman talk (*Id.*, p. 41). Vigman also commented that he was "a substantial shareholder in Aero Systems and was looking for the stock to really be a super duper stock with a sensational growth company" (*Id.*, p. 39). Holmes and Vigman were "absolutely just 'blue skying' how terrific this piece of machinery was . . . " and discussed that if "Eastern put the CD-3000 on all of their planes it would save them millions and millions of dollars . . . " (*Id.*, pp. 37-38).

b. Vigman Was Heavily Involved With Holmes in the Promotion and Publicity Program for the CD-3000

PLR started its publicity campaign for Holmes.[60] Its activities included, *inter alia*, introducing Aero Systems to

[59] Vigman not only knew the business, but he practiced it at Bunnington, as well. Around the middle or end of 1980, McNeil told Garrity that Vigman was "the one that handles the PR end of Bunnington" (Garrity, pp. 42-43, 12/16/86).

[60] PLR's distribution process included sending all releases to the Wall Street Journal office in Atlanta to get on the Dow system, and were distributed to Reuters, the New York Times

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the financial community, preparing and distributing releases to the financial community and the business, financial and trade press, placing articles in the financial publications, arranging conferences with financial columnists, updating market makers and discussing Aero Systems with numerous members of and analysts in the financial community (Exhs. 953; 959; 971; 972; 973; 978; 991; 994; 999; 1004; 1007 and 1008).

Shortly after the first press release on April 1, 1980, Vigman and Holmes didn't like the kind of exposure the CD-3000 was getting. Porter prepared a memo to Holmes[61] as to how PLR would handle Aero Systems releases in response to Vigman and Holmes' "rather strong comments about our system, the way we were making releases, and if I am not mistaken, this was because they felt the release on the CD-3000 did not get enough pick-up in the media" (Porter, p. 58; Exh. 956).

Porter had a number of discussions with Vigman about PLR's promotion of Aero Systems stock and the CD-3000 (Exh. 953, p. 407-0098; Exh. 973, p. 407-0002).

(Continued from previous page)

and onto the PR Newswire. They were also mailed out to a mailing list made up of brokers and money managers (Porter, pp. 55-56).

[61] Porter wrote Holmes that all releases were to be prepared by PLR from information supplied by Aero System, then reviewed by Aero System and released by PLR with Holmes' approval (Exh. 956). Porter testified that this procedure was followed (Porter, p. 59, ll. 16-18). Thus, PLR released nothing without Holmes' approval and Holmes is personally responsible for the releases and their content. Holmes frequently sent the releases to Vigman for review (Vigman, p. 443-444).

Vigman and Porter began to have words with each other because of Vigman's discontent with the way the material was distributed, and Porter kept telling Vigman that Vigman wasn't the client (Porter, p. 58, ll. 19-25). Vigman threatened Porter that he, Vigman, was " . . . a rather large shareholder and I have alot invested in this company." (*Id.*, p. 59).[62] Porter told Vigman that he wouldn't discuss it with him but would go through Holmes, but then things started to get rocky. Porter had problems with Holmes because of the "back-biting that Sy Vigman started to do in our firm." (*Id.*, p. 59). Holmes also told Porter that Vigman was unhappy. (*Id.*, p. 59).

After Porter told Vigman that he wouldn't deal with Vigman, Holmes called Porter and told Porter that Vigman wanted to talk to Porter about what PLR was doing

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[62] Vigman also privately told Garrity that he, Vigman, was either the first, second or third largest shareholder of Aero Systems (Garrity, p. 23, 12/16/86). Vigman privately told Eiseman that he was the largest shareholder of Aero Systems (Eiseman, pp. 79-80, 11/22/85). Plaintiffs have been unable to locate any public disclosure by Holmes or Aero Systems of Vigman's substantial stock holdings in Aero Systems, of Vigman's criminal past, of his extraordinary close association with Holmes, of his claim of being a director of Aero Systems or his pervasive control and influence over Holmes. Indeed, his shadowy presence is hidden by public disclosures to the contrary. In Bunnington's Form 8-K for March 31, 1978 relating to the Springwater sale to Bunnington, Vigman publicly disclaimed owning any Aero Systems stock and told the public that he didn't control Nettie Vigman's 206,925 shares, his two childrens' 120,000 shares or his son-in-law's 236,925 shares (a total of 11.49% of Aero Systems) (Exh. 4105). Note surprisingly, Holmes certified that the Vigmans were not a control group (*Id.*).

(*Id.*, pp. 91-92). Porter was in the position that since Holmes demanded that Porter talk to Vigman, he did it (*Id.*). Vigman wanted to know what PLR was going to do for the next several months for Aero Systems "to get the company more exposure" (*Id.*). Porter told Vigman that there were no specifics because he was waiting for dates from the financial community for Holmes to take him on the road to meet brokers (*Id.*). Vigman told Porter that he, Vigman, wanted to make sure that PLR wasn't letting down in their activity ". . . because (Vigman) *wanted the stock higher* because he thought it was worth a hell of a lot more than it was at this particular time" (*Id.*) (emphasis added).[63]

In a July 1980 conversation, Vigman told Porter that he was following Porter's activities, knew what Porter was doing and was reviewing it (Porter, p. 100). Vigman warned Porter: "I am watching what you are doing (Porter, p. 101)."[64]

c. "Friends of the Company" Assisted Holmes, Vigman and PLR

Employing the "Sponsorship" concept, Holmes used three or four "friends of the company;" a few special marketmakers that Holmes and Vigman could rely on.

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[63] Aero System's stock price had gone from a low of $2.78 bid/$3.25 ask in April 1980 to a high of $4.00 bid/4 3/8 ask in June, 1980 (Foley Decl. ¶ 135).

[64] It's very apparent that Holmes *wouldn't* move without Vigman's approval. Holmes told Porter in about July that he, Holmes, was sending copies of PLR's monthly activities reports to Vigman (Porter, p. 100; Holmes, p. 624).

Porter learned from Holmes, in conversations during the normal course of their business relationship, that there was a group of three or four people who had "been in the (Aero Systems) stock" whom Holmes considered "friends of the company" (Porter, p. 65). These "three or four" were Joe Lugo, Lewis Leeds in Florida, and Roger Garrity in California (*Id.*). Through Porter's activities on behalf of Aero Systems, he observed that the three most active marketmakers were the three; when he sent them releases, they always said who was leading the charge or who was doing what "and it always came up to those three" (Porter, pp. 65-66).[65] Porter had numerous conversations with both Lugo and Garrity and talked on a "fairly regular basis" (Porter, p. 86; Exh. 972, pp. 407-0019, 0020; Exh. 973, p. 407-0002; Exh. 978, p. 407-0313; Exh. 999, p. 407-0280).[66] Porter observed that the three were "so involved in the company" (Porter, p. 86), and he would send kits of materials out to various people at Lugo, Leeds and Garrity's request (Porter, p. 124).

Holmes' relationship with Lugo appeared to affect Porter's ability to do his job, or made his job superfluous. Porter testified that Lugo always had the Aero Systems

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[65] An analysis of Lugo's trading clearly shows Lugo's domination of the market on days when Vigman, Speyer, Diamond, or Holmes sold into the market place (Foley Decl. ¶ 124).

[66] In June 1980, Porter reported to Holmes that he'd had numerous conversations with Lugo and Garrity, and that each held a position of 900,000 shares of Aero System stock (Exh. 972).

information before Porter did (Porter, p. 88).[67] Despite the fact that PLR would make a release, but didn't know exactly when the release went out, Holmes felt that the release was out and let the people in his close group know what was going on: "That was the way (Holmes) operated. He always had this close group of bond people that he knew" (Porter, pp. 176-177).

Garrity told Porter that he "talked to Lugo constantly. That was their network. They knew what was going on on a day to day basis with each other" (Porter, pp. 88-89). Garrity also told Porter that he, Lugo and Leeds talked to Vigman frequently (Porter, pp. 87-88).

The relationship between Aero Systems and PLR deteriorated and Holmes dismissed PLR on April 20, 1981 (Exh. 1009). Porter had become increasingly concerned with AERO Systems's inability to meet its earnings projections (Porter, p. 135). Holmes had continued to refuse to give PLR statistical information regarding the CD-3000, including test information, test results and where they were selling the units (Porter, pp. 103-104).[68] A lot of reporters kept requesting the additional information from

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[67] There's a clear inference that Lugo was operating on insider information from Holmes.

[68] This is hardly surprising. As of March 31, 1981, Holmes admits that he had not received any written test results from *any* source regarding the CD-3000's performance (RFA 939). Holmes didn't *have* any written test results reported until July, 1981 (Holmes, pp. 44; 1910-1911; Exh. 1039). Further, only 10 CD-3000's had been sold by the date of PLR's dismissal (Exh. 5284). For Holmes to disclose the truth of the number of sales to the financial press would have been devastating to his stock price.

PLR, but PLR had no way of getting it because Holmes wasn't being responsive and simply kept putting off supplying the information (Porter, pp. 103-104).

Porter testified that the split between PLR and Holmes was caused by, among other things, a personality problem between corporate officer (Holmes) on the one hand who started the company with his bare hands and believes what he's doing, and a public relations person who, above all, believes in credibility and feeding proper information to the financial community (Porter, pp. 200-202). Porter wanted information to come out on what was actually going on *vis a vis* Aero Systems's projections (*Id*). Most significant however, is Porter's statement that "[t]here was, if you will, a behind-the-scenes force going on there just by Mr. Vigman in whatever they were doing together as far as operating this company, and their philosophy certainly differed from mine" (*Id.*, at 202). Garrity was a little more direct on the rift; Porter told him that Porter felt Holmes lied to him (Porter) about the CD-3000 (Garrity, pp. 40-41; 265-268).[69]

2. Holmes, Vigman and Porter, LeVay & Rose Issue False Press Releases

a. April through June 1980

Holmes was responsible for the preparation, content and distribution of Aero Systems' press releases (Holmes,

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[69] There is a strong inference that Holmes and Vigman didn't need PLR anymore. Between September 1, 1980 and the time PLR was discharged (April 20, 1980), Vigman, Speyer and Holmes had already sold 296,925 shares of Aero Systems stock for $1,796,499 (Foley Decl. ¶ 134).

p. 3025). Nothing went out from the company without Holmes' approval (*see* fn. 61, *supra*). Holmes discussed press releases with Vigman (Vigman, pp. 443-444); he sent press releases to Lugo (Holmes, pp. 109-276). There is no evidence anywhere that Holmes ever modified, changed or retracted any press release, news article, quotation, shareholder letter, annual report or other public document, once that item had been publicly disseminated.[70]

Holmes' very first press release on April 1, 1980 regarding the CD-3000 (Holmes, p. 658; Exh. 947) states that "The potential market for this much needed new product includes all multi-engine jet, turbo prop and piston aircraft in the word." Thus, Holmes included all of the world's airlines and all of the world's general aviation aircraft in his "potential" market, having done no market study, having no test results and having been told by the inventor that the market Holmes described to the public is not the market for the product.[71] Holmes also

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[70] Holmes testified that he tried it once, but that there's no way "to get these things changed" (Holmes, pp. 379-380).

[71] Both Vigman and Holmes gave input to Porter for the press release (Porter, p. 38). Vigman and Holmes told Porter that the CD-3000 was "designed to reduce fuel consumption by 15%" (Porter, p. 47) and was reflected in the first draft of Porter's first press release (Exh. 948). There is no basis anywhere for a claim of 15% fuel savings. In fact, at the time of the release, neither Holmes nor Colt *had* any empirical written test results concerning what or what not the CD-3000 would save (Lynn, pp. 87-88; Holmes, pp. 46-47), and Holmes knew this (Lynn, pp. 89-90). The actual first press release didn't include any reference to any alleged fuel savings. The fact that Holmes and Vigman told Porter that the device saved 15% fuel, however, clearly shows the two of them creating "percentages" out of whole cloth.

states that he plans to market through a "selective network of dealers. Holmes didn't sign up his first dealer for the CD-3000 until September 14, 1981 (Exh. 8001), eighteen months after he signed the CD-3000 agreement.

On April 23, 1980 (a day after the final agreement was signed between Colt and Aero Systems), Holmes announced that Aero Systems planned to lease the unit "to commercial and business aircraft operators . . . in exchange for a percentage of actual fuel savings" (Exh. 5203). Holmes then stated that "airlines alone will spend more than $30 billion for fuel this year" (*Id.*) The obvious effect sought was that Aero Systems would get, by its leases, that percentage of the $30 billion of fuel saved (Holmes, pp. 105-106). By analyzing Exhibit 5284 which lists all CD-3000 sales and the price paid, through November 1987, it is clear that Aero Systems never entered into any such lease. There was no public announcement that Aero Systems's "plan" was not implemented.

On April 28, 1980 Holmes prepared and sent a letter to Aero Systems' shareholders which states, *inter alia*:

> 1. "[W]e are very pleased . . . to inform you of a very exciting new development that could be the most significant event in our history."
>
> 2. "[W]e are entering an exciting new market . . . ")
>
> 3. "[P]resent business jet users have indicated fuel savings to be in the area of 10%."
>
> 4. "[O]ur initial market includes installation in the 50,000 plus multi-engine jet, turbo prop and piston aircraft currently in operation . . . "

5. "[W]e are currently discussing a leasing proposal with one of the major air carriers . . . in exchange for a percentage of actual fuel cost savings."

6. "[T]he potential savings could be a fantastic amount since the world's airlines are expected to spend more than $30 billion for fuel this year, a third of that amount by the U.S. Airlines."

7. "[W]e are thrilled with the added potential of this exciting new high technology product that could be greater than everything we have done throughout our entire history." (Holmes, p. 108; Exh. 5204)

The non-existent "market" identified by Holmes consisted of over 50,000 aircraft of all kinds through the world. There are no facts that Holmes possessed that every aircraft in the world could or would use the CD-3000.[72] Holmes testified that he merely pulled the figure out of Jane's All the World Aircraft (Holmes, p. 109). However, there is still no support for Holmes' claim that all the world's aircraft could or would use the device (Declaration of Davies, ¶¶ 3-5). Further, Holmes doesn't disclose that Colt's capacity to produce the CD-3000 is

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[72] In fact, Davies testified that general aviation aircraft operators (*e.g.* twin piston, turbo-prop, etc.) would not be interested in the CD-3000 because of its high relative cost (Davies, p. 107), because the cost of fuel is a very small part of the cost of small plane ownership (Davies, p. 69), and because fuel quantity, fuel flow, and gross weight information is available with less expensive devices (Davies, p. 107). And, as Airlift International's Robert Sovacool observed, all new generation jets have more exotic fuel management systems as original equipment (Sovacool, pp. 24-25; *See also* Davies Declaration ¶¶ 3-5).

extremely limited.[73] Holmes doesn't disclose Colt's reservations as to the CD-3000's limited market appeal, or the inventor's warning that airlines won't use it.

i. Holmes' Claim That The CD-3000 Saved 10% Fuel Consumption Was False

Holmes' representation that "business jet users have indicated fuel savings to be in the area of 10%" was false and known to be false at the time it was published.

Holmes admits that there were no written test results of the CD-3000 before he signed the agreement with Colt (Holmes, pp. 46-47). He never received *any* written test results from anyone at Colt (Holmes, p. 48). Holmes admits that the first written test results of any tests on the CD-3000 he or Aero Systems received were in July of 1981 (Holmes, pp. 444; 1910-1911; Exh. 1039).

Holmes claims that Lynn and Hayden of Colt *told* him that fuel savings were in the area of 10% (Holmes, p. 117), and that Hayden had told him that Smith (a pilot for Landis Tool) was "getting about 10%" (Holmes, p. 120).

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[73] Lynn testified that in 1979-1980 Colt had about 10 people of whom three were in production (Lynn, p. 20). In 1980, Colt had only 7,500 square feet and "probably five" people in production (Lynn, p. 21). Colt maintained a "very small" inventory of three to five CD-3000s, and after the Aero System agreement they produced CD-3000s on an "as needed" basis (no inventory was maintained) (Lynn, pp. 57-58). It took Colt three (3) months to produce a CD-3000 from date of order and, all things being equal, Colt could only have produced "several hundred" per year (Lynn, pp. 58-59).

However, Lynn denies that there are or ever were any empirical test results from the CD-3000, or that he every gave any to Holmes (Lynn, pp. 110-111). Lynn doesn't even recall any customer telling him that there was a percentage fuel savings by using the CD-3000 (Lynn, p. 31). Lynn never even knew of a percentage savings or fuel maximization, nor did anyone else to his knowledge (Lynn, pp. 28-29). As Lynn stated: "We have no idea what the fuel management computer can save a person in economy" (Lynn, p. 28). Lynn does not recall any discussions with Holmes or Vigman during his March 1980 trip to Miami related to percentage of fuel savings, and at that time there were no test results (Lynn, pp. 87-88). Hayden does not remember "ever saying 10%" (Hayden, p. 42).

Lynn says that Hayden was bandying about the 10% savings numbers, but that there was no test data to support it (Lynn, pp. 89-90), and if percentage figures were passed on to Holmes, Holmes was told that there was no test data to support them (Lynn, p. 101). Lynn further testified that any percentage figure was "pure speculation" and Holmes was told that it was (Lynn, pp. 100-101).

Smith (a pilot at Landis Tool, one of the two business jet operators who had installed the CD-3000 before Aero Systems entered into the agreement with Colt) never represented to anyone at Aero Systems or to anyone on behalf of Aero Systems that fuel savings were possible with the CD-3000 (Smith, p. 40). As a matter of fact, Landis Tool bought the device because it provided more information; they did not buy it to conserve energy, and never used it to conserve energy (Smith, pp. 45-47).

There is no evidence anywhere that Holmes obtained testimonials from "business jet users" that the device saves 10% of fuel before Holmes made that claim in his public announcements.[74]

ii. Holmes Failed To Disclose Significant Limitations On The CD-3000's Capabilities And Usefulness

Holmes also failed to disclose to the public the technical capabilities, or lack thereof, of the CD-3000. Holmes failed to disclose that:

(1) Reservations expressed by the inventor and manufacturer regarding the market Holmes was claiming (Hayden, pp. 21-22; 141; Lynn, pp. 90-91);

(2) The use of the CD-3000 is very limited. The CD-3000 only is capable of use on the "cruise" portion of the flight, and thus the interest of any airline depended on the "block times" of the airlines' flight schedules.[75]

(3) At the time of the agreement between Colt and Aero Systems, the CD-3000 was not capable of being used on aircraft weighing over 100,000 pounds. (Lynn, pp. 114-116) and was not

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[74] The totality of the shareholder letter is not only abnormally hyperbolic, but gives the potential stock purchasers the distinct impression that Aero Systems, by its "leasing" arrangement to a U.S. airline, would garner earnings equivalent to at least 10% of 10 billion dollars (one third of the $30 billion spend on fuel by the world's airlines).

[75] (Hayden, pp. 267-268; Exh. 2406).

available in a model for such use until six (6) months after the agreement was signed (*Id.*).[76]

(4) Prior to the sale of the CD-3000 the FAA had to issue a Supplemental Type Certificate ("STC") for use of the device on any given type aircraft for which it was purchased. (Sovacool, p. 56). From the time of the application until the STC is obtained can be from three to six months (Hayden, pp. 34-35).[77]

(5) The use of the device would slow a commercial jet down and that commercial airlines, as Hayden warned are tied to a tight schedule and would not adopt a device that interfered with that schedule;[78]

(6) Use of the device depended heavily on pilot acceptance and, as pilot Smith said, in

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[76] Virtually all of the commercial airlines and all cargo carriers operated in the time frame from April 1980 to July of 1981 operated at gross weights in excess of 100,000 pounds. (Declaration of Davies ¶ 2). These aircraft included the following makes and models: Lockheed L-100, L-1011; McDonnell Douglas DC-8, DC-9, DC-10; Boeing 707, 727, 737, 747. *See also* Holmes Response to RFA 652. The CD-3000 couldn't be installed on aircraft in excess of 100,000 pounds until at least September, 1980 (Exh. 2413).

[77] Once an application for an STC is made, a FAA inspector must issue a Type Inspection Authorization, and then a FAA inspector has to test the unit for safety and compatibility with that specific type of plane (Hayden, pp. 30-31). After all of these steps are completed, then the FAA will, in time, issue the STC (*Id.*). Only two types of business jets had CD-3000 STC's at the time Holmes signed the agreement with Colt (RFAs 167-168). In fact, only four STC's had been issued prior to mid-1982 (Exh. 2402).

[78] *e.g.*, American Airlines advised Holmes in (August 6, 1981) that they considered time to be more critical to their operation than fuel savings (Holmes, p. 2154; Exh. 3882).

order to utilize the device, one would have to operate outside the flight manual; "Flight manual is Bible. You don't ever do that" (Smith, pp. 36-38);[79]

(7) The lack of capabilities of Colt to manufacture the CD-3000 in the gross numbers of the "market" that Holmes was leading the public to believe existed for the device.[80]

On the same day of Holmes' shareholder letter the same material was published by the National Quotations Bureau, Inc. (Exh. 116).[81]

On June 9, 1980, Holmes caused to be published an advertisement in Barron's which said "Initial results from business jet users indicate fuel savings to be in the area of 10%" (Holmes, p. 1695; Exh. 3806).[82]

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[79] Roy Johanson, Aero Systems' VP-Marketing, who reported directly to Holmes (Johanson, pp. 13-14), testified that the CD-3000 was less successful with airlines than business jets due to poor pilot acceptance (Johanson, pp. 77-78). Pilots were not inclined to use the CD-3000 because of their cockpit work load. Johanson discussed these opinions with Holmes, but Holmes thought he could overcome lack of pilot acceptance through "marketing" (Johanson, pp. 80-82).

[80] *See* footnote 73, *supra*.

[81] Holmes admits that he periodically sent information to the Grinde Organization (NQB publisher), but does not know if he sent this to the Grinde Organization (Exh. 116; Holmes, pp. 135-137).

[82] The use by Holmes of the plural "users" is not just disingenuous but is a deliberate misstatement calculated to deceive the public into thinking that the business jet market was crowded with the devices. Holmes only claims to have spoken to Smith of Landis Tool (*supra*, p. 62) and Lynn and

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b. July 1980

During April, May and June 1980, Aero Systems stock price remained fairly level from a low 2 7/8 bid/3 1/4 ask to 4 bid/4 3/8 ask (Foley Decl. ¶ 135). It's during this time that Holmes and Vigman were expressing dissatisfaction with PLR's program.

On July 1, 1980 PLR prepared and sent Holmes a draft of a "proposed fact file" which was "intended to outline Aero's operations succinctly for members of the financial community" (Porter, p. 74; Exh. 969). Holmes redrafted the "fact file" and sent it back to Porter (Porter, p. 76; Exh. 969, pp. 407-0563-0566). Porter redrafted it again, taking out some of what Holmes had inserted and finalized it (Porter, p. 77; Exh. 969, pp. 407-0567-0573). The "fact file" and Holmes' revisions are very significant.

First, Holmes reiterates the false claim that "initial results from business jet users indicate fuel savings to be in the area of 10%" and the false claim that the initial market for the device is "50,000 + multi-engine jet, turbo prop and piston aircraft . . . " These misrepresentations stayed in the final "fact file."

Second, Holmes added that "As of June 30, (1980) Aero Systems met the final requirement of the Federal

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Hayden of Colt (*supra*, p. 62). Smith (who denies he told Holmes anything about a 10% savings) is the *only* business jet "user who could have been Holmes' source. Further, by use of "initial results," Holmes is telling the public that there were some tests conducted on the CD-3000 giving "initial results." There were no tests and no "initial results."

Reserve Board to qualify its stock for sale on margin and expects to be included in the next qualified list to be published in October. This factor alone should greatly enhance the value of the stock" (Exh. 969 at p. 407-0565).[83] This was included in the final "fact file" except for the last sentence (*Id.*, 407-0561); while not expressly said to the public, the last sentence clearly shows that qualifying for margin was part and parcel of Holmes, Vigman and Lugo's carefully conceived plan to raise the Aero Systems stock price without any underlying economic justification.

Third, Holmes adds "We see Aero Systems as the best buy in the market today for capital appreciation and would not be surprised to see the value of this stock triple before the end of this year" (*Id.*, p. 407-0565). While this was muted substantially by Porter in the final version (*Id.*, p. 407-0573), Holmes' unsupported enthusiasm and actual motive underlying the acquisition of the marketing rights to the CD-3000 is abundantly clear.

Finally, Holmes recklessly, if not falsely, projects sales and earnings of an unprecedented and unsupportable amount attributable, in part, to the CD-3000. Porter's original draft of the "fact file" (*Id.*, pp. 407-0558-0562) says nothing about Aero Systems' earnings. In Holmes' redraft for PLR's use in the fact file (*Id.*, pp. 407-0563-0566 at p. 406-0563), Holmes wrote:

> Aero Systems Inc., is the most exciting situation that (Porter LeVay & Rose) have ever had to work with. (PLR) believe(s) the Company is on

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[83] The Federal Reserve Board approved Aero Systems' stock for sale on margin in early October, 1980 (Exh. 123).

> the verge of a major breakout in both sales and earnings, that could exceed $50 million in sales and $1.50 to $2.00 in earnings by 1983 as a result of:
>
> x x x
>
> c. Sale and lease revenues from the Company's unique new Fuel Saving Computer which potentially could dwarf the Company's entire operations.

Holmes' predictions appeared in the final "fact file" (Exh. 970, p. 407 0153).[84]

The final version of the "fact file", together with Holmes' letter to shareholders was sent by mail to approximately 5,000 members of the financial community (Porter, pp. 81-82; Exh. 970).

PLR's report had the desired effect. As Porter reported to Holmes on September 22, 1980 concerning PLR's August 1980 efforts: "The report was widely distributed . . . We have received numerous responses from the report and have seen an increase in the stocks' activity . . . *Roger Garrity* of Investors Financial Services, Inc. and *Joe Lugo* of First State Securities *both told us that the*

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[84] Aero System's *actual* sales and earnings were:

	1981	1982	1983
Sales	$14,487,016	$17,263,786	$26,918,626
Earnings	.06	.10	.21

Aero System 1983 Annual Report (Exh. 5261)

interest in the stock is being generated from the report" (Exh. 978) (emphasis added).[85]

Also, in July 1980, Holmes was interviewed by Martin Merzer of the Miami Herald and told Merzer the falsehood that "Our tests show (the CD-3000) can result in fuel savings of up to 10%" (Exh. 119; Merzer, pp. 8-9). Aero Systems had received no written test results (RFA 945).[86]

c. Holmes, Vigman and PLR Get Moore Schley to Join Their Forces and the False Releases Continue.

At the time PLR prepared and disseminated its "fact file," Holmes, Vigman and Lugo found another "friend of the company" in a small brokerage firm in New York, Robertson Securities and its clearing broker, Moore & Schley, Cameron & Co. (both referred to as "Moore Schley").[87]

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[85] During this time period, PLR, *inter alia*, prepared and distributed to the financial community at least four releases on the CD-3000 (Exh. 953, p. 407-0096; Exh. 959, p. 407-0080; Exh. 971, p. 407-0028).

[86] Aero Systems claims to have conducted tests, but the tests didn't provide any percentage of fuel savings because Aero Systems wasn't "actually using any fuel" (Holmes, pp. 185-186).

[87] Holmes opened an account at Moore Schley (Sayegh, p. 51). In November of 1980 Holmes sold 50,000 shares of his company for over $8.00 per share and received $409,095 (Exh. 3863). Vigman also opened an account for himself or his children at Moore Schley to sell a block of Aero System stock

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Messrs. Sheidy, Augus and Figliozzi of Moore Schley traveled to Miami to visit Holmes on September 16, 1980 (Sheidy, p. 57).[88] At the conclusion of the meeting, even before they returned to New York, Figliozzi or Sheidy called Sayegh, Moore Schley's trader, and told Sayegh to buy and accumulate Aero Systems stock (Augus, pp. 38-39). Only three days later, on September 19, 1980, Moore Schley issued a stock "analysis" letter prepared by Augus (Augus, p. 21) not only stating that Moore Schley was a market maker of Aero Systems but containing false and misleading statements (Exh. 117). It states that "The system has indicated, in early testing, fuel savings in the area of 10%." Augus testified that Holmes "showed us some test results" and "he went over the test results with us" and said that "early testing had confirmed it was a substantial fuel saver" (Augus, p. 55). Thus, Holmes fabricated those "test results" for Augus because Holmes has unequivocally admitted that he had received no written test results concerning the CD 3000 in September 1980 (RFA 961).

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(Vigman, pp. 266-269). Moore Schley also filled out a new customer account form for Joan Vigman, Vigman's daughter, from information provided by Holmes, the purpose of which was to allow the sale by her of 25,000 shares of Aero System stock (Sayegh, p. 68; Holmes, pp. 1074-1075; Exh. 160). Holmes introduced Diamond to Moore Schley and Diamond opened an account there in July of 1982 (Figliozzi, pp. 212-216; Exhs. 163, 164). Speyer and Michael Lipman [Vigman's son-in-law (Vigman, p. 25)] both sold 20,000 shares of Bunnington through Moore Schley in March 1982 (Figliozzi, pp. 344-346, 353; Exhs. 192-195).

[88] Before Porter had prepared PLR's "fact file," Porter had discussed Aero Systems with Moore Schley (Porter, p. 79).

Further, Moore Schley's stock "analysis" again falsely reiterates that the market for the device is "50,000 aircraft" (Exh. 117). It, like the PLR report, omits to mention any of the critical facts about the device that the public would need to know to make an intelligent decision on the purchase of Aero Systems stock.

Six days later, on September 25, 1980, Moore Schley issued another incredible Aero Systems stock "analysis" which is ten (10) pages long (Exh. 118).[89] Augus repeats the false claim about "early testing" showing fuel savings "in the area of 10%" (Exh. 118, p. 1).[90] It *expands* the false claim of the "market" for the device to "50,000 private aircraft, 5500 commercial aircraft and . . . a large number of military aircraft" (*Id.*, p. 2). Incredibly, the analysis goes on to claim (on pp. 7-8) that "this (fuel) savings varies between 4 and 16%. This has been borne out by extensive testing in the current units installed in the deHavilland . . . , Saberliner and . . . Jetstar." Augus testified that "my report [Exh. 118] was done from things that I had in my file. Whatever is in this report was in my file" (Augus, p. 138). *No* such information concerning the

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[89] Augus, who wrote the long report, says that the reason that the one page report was put out was because "the stock started to get very, very active and started to move up . . . we decided not to wait for the printer (who had the long report) . . . The stock was headed higher" (Augus, pp. 37-38).

[90] The effect on the financial community of the group's "10% fuel savings" barrage was reported to Holmes by Porter in the PLR September activity report (Exh. 991). At Exh. 991, p. 407-0325 Porter reported that a Paine Webber representative had told him " . . . that a 75 hundred dollar investment could reduce overall fuel expenditures by a minimum of 10% is 'just phenomenal'."

alleged test reports or market data was in Augus' file (Taylor Decl. ¶6). Again, there was no such written test data, let alone "extensive" test data extant at the time of this "analysis" (Holmes, p. 204, 11. 17-22; RFA 945). Finally, Holmes reviewed the September 25, 1980 Moore Schley report and provided his comments on it to Jules Augus (RFA Nos. 215, 216). Again, the report omitted the significant facts that were or should have been known to Holmes.

The evidence is clear that Moore Schley joined the conspiracy to manipulate Aero Systems' stock. Great shards of Augus' "analysis" are lifted *verbatim* from the PLR "fact file" of a month earlier (*cf.* pp. 2-7 of Exh. 118 to PLR's "fact file" Exh. 5208).[91]

Augus vehemently denies that he copied PLR's "fact file" when confronted with the identical parts of the two reports (Augus, pp. 102-150). He goes further at p. 150: "I say this unequivocally. I never dealt with Porter, LeVay relative to Aero Systems. Personally, I never dealt with them in this stock, never." He also swears, "No, sir. I met Mike Porter subsequent, maybe a couple of years later- . . . but I had no dealings with Porter, LeVay concerning Aero Systems" (*Id.*, p. 151). Augus did not testify truthfully.

In Porter's report of PLR's September 1980 activity, he shows that PLR met with "representatives" of Moore

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[91] Porter testified that he had received the Moore Schley report but that he "never read it" and only "realized afterwards this was my report or at least the basis (for it)" (Porter, p. 80, 11. 4-13).

Schley and Mike Porter "[d]iscussed distribution of the Moore & Schley, Cameron report with *Jules Augus. We set up lines of communication for brokers from all over the country to get copies of the report*" (Exh. 991, p. 407-0318) (emphasis added). In October 1980 Porter reported regarding his activities for Aero Systems stock that he "[m]et with Bob Sayegh, Bob Figliozzi and *Jules Augus* . . . (Exh. 994, p. 407 0298) (emphasis added). In January 1981, Porter met with Scheidy and *Augus* and discussed PLR's plans and program for Aero Systems (Exh. 1007, p. 407-0349). PLR's Report for February and March 1981 shows that Scheidy and Figliozzi met with PLR regarding Aero Systems stock (Exh. 1008, p. 407-0378).

They were, as it were, as thick as thieves, and set about to announce the gross misstatements, with the significant omissions, to the public.[92] The impact of the Moore Schley "analysis" was significant as reported to Porter and passed on by Porter to Holmes and Vigman.[93] The Moore Schley report – and its misstatements – were also forseeably picked up and parroted by publications like the Portfolio Letter of September 29, 1980 (Exh. 120).

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[92] Porter reported to Holmes in PLR's October report of September, 1980 activities that PLR had arranged for Augus of Moore Schley to talk to a Dean Witter representative (Exh. 991; p. 407-0324).

[93] Brokers and analysts to whom PLR spoke in September (Exh. 991) reported that they'd read Moore Schley's report (*Id.* pp. 407-0320; 0322; 0325; 0327; 0330); that they found it excellent (0322); that the "company has tremendous upside potential" (0325); that it and the PLR report "awakened up the financial community to the potential in Aero Systems" (0327) and that they "found the company extremely interesting" (0330).

The impact that Holmes, Vigman, PLR, and Moore Schley had on the market for Aero Systems stock is underscored in the testimony of Lawrence Waters ("Waters"), a securities broker for the Investment Corporation of Virginia. Aero Systems first came to Waters' attention in approximately October 1980, when he received a Moore Schley publication featuring the company (Waters, pp. 36-38). Waters described the publication as a "beautiful booklet, pamphlet" (*Id.* pp. 110-111).

Waters spoke with Holmes, who told Waters that several airlines were interested in the CD-3000, and that Aero Systems was "expecting a contract in a couple of weeks" (*Id.*, p. 49). Holmes represented to Waters that with the CD-3000 a major domestic airline, such as Eastern Airlines, could save tens of millions of dollars annually (*Id.*, p. 50). Waters regarded this as an "impressive thing" (*Id.*). Waters remained in contact with Holmes, who continually represented that the contract was always coming "shortly" (*Id.*, p. 72). Waters began to recommend Aero Systems stock to his customers in October 1980 (*Id.*, p. 93), stating that "this thing definitely had the charisma to it. Timing was right, everything was right about it" (*Id.*, p. 96).

Waters did not understand, however, why the CD-3000 never sold since "[Airlift] had tried it, and they had proved beyond a shadow of a doubt, according to what [Holmes] said, that it was definitely a savings of fuel and from that [Aero Systems] expected a contract imminently, and it never came" (*Id.*, p. 74-75).[94] Waters

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[94] See Section 2d below re "Airlift."

testified that Aero Systems' actual earnings were "a disaster" (*Id.*, p. 98), but that "if the CD-3000 clicked the company was on the road to financial stardom. That was the key right there" (*Id.*, p. 101).

Waters stated that without a contract to sell the CD-3000 to an airline, no one should have ever paid more than $5 for Aero Systems stock since "the rest, the five to nine, was the hype" (*Id.*, p. 107-108). From October of 1980 through the end of 1981 most of Waters' clients who purchased Aero Systems stock sold it for a loss (*Id.*, pp. 111-112). Waters attributed the rise in Aero Systems, in part to the activity of firms like Moore Schley (*Id.*, p. 103).[95]

Moore Schley didn't stop with the September 25, 1980 report. Augus issued a follow-up report on November 1, 1980, again restating the false claim that "early testing" showed "fuel savings in the area of 10%" and the false claim of the extent of the market (Exh. 127).

During this time, PLR not only worked hard in step with Moore Schley, but they continued their promotional program of Holmes and Aero Systems. They managed for Holmes to appear in Chicago before a group of brokers in

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[95] Ronald Rotstein, Editor of Capitalgains and an investment advisor (Rotstein pp. 12; 121) concluded from the overall activity in Aero Systems and Aerosonic stocks that there were "certain probabilities that would indicate that there was some type of organized effort in the security . . . " that " . . . the amount of activity suggests to me that there may have been some type of collusionary effort . . . " and that " . . . the activity in these two stocks, particularly . . . Aero Systems, particularly with respect to the volume and price, I thought that that was unusual" (pp. 118; 121).

October 1980 (Exh. 994); they arranged for interviews with Alan Wax, a business reporter for the New York Post, and Paul Stouffer of Investment Dealers' Digest (*Id.*), both of which resulted in articles.

Alan Wax's article appeared in the New York Post[96] on October 13, 1980 and states, once again, that the "unit- . . . can reduce an airplane's fuel consumption by as much as 10 percent" (Exh. 147). This is patently false. Further, Wax attributes to Holmes that "one foreign government already has ordered 250 units . . . " (*Id.*).[97] This is untrue. Porter proudly sent the article to Holmes (Exhs. 986, 994). Wax testified that his article was based on a telephone interview with Holmes (Wax, pp. 30-31), press releases (Wax, p. 28), promotional materials from PLR (Wax, pp. 33-34), and a discussion with Jules Augus of Moore Schley & Cameron Co. (Wax, p. 39). There is no evidence of any correction or retraction by Holmes.

Stouffer's article appeared in The Investment Dealers' Digest in December of 1980 (Exh. 1442). It says "[i]nitial results from business jet users indicate fuel savings to be in the area of 10%. The market for this product includes all multi-engine jet, turbo-prop and piston aircraft in the world." It also omits the same critical information as did Wax's article. Significantly, PLR brought Aero Systems to Stouffer's attention (Stouffer, p. 18).

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[96] At the time that this article was written, the New York Post had a circulation rate between 600,000 and 900,000 papers daily (Wax, p. 22).

[97] Holmes admits that as of November 1980, Aero Systems had not received orders for 250 CD-3000's from any source or aggregate of sources (RFA's 221-225).

When Stouffer called Aero Systems, "Holmes insisted on doing all of the speaking himself" (Stouffer, p. 19), and told Stouffer that "the exciting new product [CD-3000], has all the potential . . . to become the major portion of the firm's business, far outdistancing its present products" (Stouffer, p. 38).

All of the sudden interest in Aero Systems stock was compounded by another Aero Systems marketmaker, Wheat First Securities, issuing a stock report on Aero Systems on November 6, 1980 (Lind, pp. 10-11; Exh. 5767). Again, Wheat First states that "initial results from business jet users indicate fuel savings as high as 10% . . . " and that the "market potential . . . includes 5,500 units for commercial airlines, 50,000 for multi-engine general aviation aircraft, 8,500 for helicopters[98] and an extremely large military market." Lind's experience virtually mirrors Stouffer's contacts with Aero Systems. Moore Schley promoted Lind's interest in Aero Systems (Lind, p. 15), and Lind reviewed materials Moore Schley prepared on Aero Systems (Lind, pp. 26-28). Lind met with Holmes at Aero Systems in Miami in preparation of the November 6, 1980 article (Lind, p. 34).

Lind described Aero Systems as "a company that had a technology angle in it, or there was a technology play

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[98] This is a falsehood. Helicopters have absolutely no use for such a "fuel savings" device. For all helicopters, maximum specific range occurs at the limit speed of the aircraft. Therefore, to maximize specific range, the pilot simply flies the helicopter as fast as it will go (Davies, pp. 54-57). Holmes admitted that the CD-3000 was never tested in a helicopter (Holmes, p. 279).

within it in the company" (Lind, p. 21). Lind viewed Aero Systems as "a base business, but with a potential technology lever" (*Id.*). That lever was the CD-3000, and that without "the potential rewards that could be generated from the CD-3000," Lind would not have written the article (Lind, pp. 22-23). Holmes saw the report and, despite the misrepresentations and omissions, did not correct or attempt to retract it (Holmes, p. 279).

Further, the November 1980 Investment Alert carried the same basic story with the same omission (Exh. 130). However, it categorically states that "[t]his system *can* effect fuel savings up to 10%" (emphasis added).

On January 5, 1981 Mike Pollick and the Orlando Sentinel Star reported that Aero Systems concluded that the U.S. market for the device includes 6000 commercial planes and 50,000 general aviation planes. He also notes that the "company's own projections indicate very rapid growth in sales and earnings" (Exh. 5223).

Holmes then sent out a shareholder letter on January 12, 1981 (Holmes, p. 361; Exh. 5224). He states that "several airlines are on the verge of placing orders . . . and we have many pending orders from the business aircraft market." These statements are false; Holmes knew that *no* airlines were on the "verge" of buying the device. Further, there were *not* "many pending orders" for business jets. In fact, there were only *two* orders for the device "pending" at the time of Holmes' shareholder letter; one each to Associated Radio, Co. and Arkansas Modification Center (Exh. 5284).

Holmes' shareholder letter is also significant in that, for the *first* time in *10 months* since Holmes signed the

agreement, Holmes stated he's *starting* to advertise the device to the *aircraft* market – rather than advertise the device to his *stock* market.

Of course, Moore Schley trumpeted the same false "facts" in its memo of January 12, 1981 to its customers and brokers (Exh. 133). Moore Schley added that they were "confident that results will be substantially greater . . . sparked by expected orders for the CD 3000 . . . " (*Id.*).

Holmes further fueled the fire by appearing on "The Nightly Business Report" (Channel 2, Miami) on February 4, 1981 with reporter Eugene Teibloom (Teibloom, pp. 30-32; Exhibit 5228). Holmes requested the videotape of the appearance and distributed it widely (Holmes, pp. 833-836). The text repeats that the device "reportedly produces fuel savings of 10 percent on private planes . . . " Moreover, in the release, Holmes made a new misrepresentation that *commercial airlines* using the device can produce "an estimated 4 to 10 percent" savings for which there is absolutely no foundation (Exh. 5228).[99]

Finally, the totality of the release regarding the Teibloom interview clearly implies that Eastern Airlines

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[99] It was only eight days before, on January 27, 1981, that Holmes signed an agreement with Airlift International, Inc., described as a "commercial airline", to *provide* Aero Systems with "documented fuel saving operating results" (Exh. 5226); none whatsoever existed at the time of the Teibloom show (Sovacool, p. 69). Also, this is the first indication to the public that Holmes and Aero Systems are finally trying to sell the device to an airline, the very target Holmes saw for the device nearly a year earlier.

would buy the CD-3000 and that the device would save 5% of fuel costs amounting to $50 million dollars in 1981.

The misrepresentations concerning fuel savings continued. In March 1981, in the ABD, Aero Systems placed an ad claiming "up to 10% fuel conservation" (Exh. 5234). Smart Money published an article in its April 1981 issue stating that "[w]ith the CD-3000 a pilot can save from 4% to 16% (of fuel) . . . " (Exh. 137). Also, in an article appearing in the OTC Review in July 1981, it's again reported that the CD-3000 " . . . is designed to reduce an airplane's fuel consumption by as much as 16 percent . . . " (Exh. 5244A). On June 17, 1981 Holmes released over PR Newswire that "The CD-3000 . . . *can* save up to 10% of the fuel consumption . . . " (Holmes, pp. 500-501; Exh. 5242) (emphasis added).

d. Holmes Released Faise and Misleading Information Regarding Airlift International

On January 27, 1981 Holmes issued a press release stating that Aero Systems had signed an agreement with Airlift International, Inc. ("Airlift"), describing Airlift as the "first commercial airline user" of the CD-3000 (Exh. 5226). Holmes claims that "Airlift will also provide Aero with documented fuel savings operating results" (*Id.*). This announcement appeared in Barron's on February 2, 1981 (Exh. 5227), the February 9, 1981 Aviation Week publication (Exh. 5232), and Fortune Magazine on March 9, 1981 (Exh. 5235).

Holmes failed to disclose that all Airlift flew as a "commercial" airline were freighters (Sovacool, p. 57) and that the CD-3000 was going to be "tested" on Airlift's

long distance airplane (Sovacool, pp. 57-58). He did not disclose that such "tests" on a single aircraft vary not only with respect to the types of aircraft involved but aircraft within the type itself (Sovacool, pp. 123-124). He failed to disclose that loss of time caused by use of the CD-3000, a serious concern of passenger airlines, was of no concern to Airlift (Sovacool, p. 164). He failed to disclose that slowing cruise time[100] of an airline aircraft increases crew and maintenance costs, and that as incremental costs approach the marginal cost of fuel, the value of the CD-3000 diminishes (none of which was considered by Airlift or in its report) (Sovacool, pp. 130-131). Finally, he failed to disclose that the pilot can obtain the same results by using a flight plan as from using the CD-3000; the CD-3000 only makes the information more convenient (Sovacool, pp. 82-83).

Holmes then sent a letter to shareholders on March 16, 1981 telling them that Aero Systems is "currently installing [the] CD-3000 . . . on our first large commercial jetliner" (Holmes, p. 383; Exh. 1011). He makes the same omissions, and additionally, chooses not to name Airlift International. He finally acknowledges that "pilot acceptance is the key" to the success of the device (*Id.*), one of the cautions told to him by Hayden a year before.[101]

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[100] Cruise time is the time that you enter into a steady state operation from the top of the climb until the top of the descent (Sovacool, pp. 128-129).

[101] The prospect of "real" test data from Airlift International also coincided with Holmes' discharge of PLR on April 20, 1980 (Exh. 1009). It's submitted that Holmes didn't need PLR's further assistance or costs in disseminating Holmes' phoney statistics.

Holmes continues to emphasize that the company is "on the verge" of success; *i.e.*, " : . . . [t]he documented results are expected to be the trigger to volume sales and leases to the world's major airlines. We are now more confident than ever about the success of our CD-3000 . . . and feel we are on the verge of a major breakthrough" (*Id.*).

On May 7, 1981 Holmes issued another press release (Exh. 1038).[102] Holmes reveals that "preliminary indications" of the testing by Airlift "appear to be quite significant" (*Id.*). He "quotes" Sovacool to the effect that he, Sovacool, has recommended that Airlift "outfit the entire fleet" with CD 3000's.[103] The letter further states that the tests have not been completed, and Holmes says the tests are scheduled to "continue for another week . . . " after which the data must be "consolidated and compared with prior fuel consumption . . . in order to document . . . fuel savings." The alleged test data on which the *final* report was based was already completed by this date; the final report shows the "testing" took place between March 15 and April 15, 1981 (Sovacool, p. 120; Exh. 1039). Thus,

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[102] On May 1, 1981 – six days before this first public release which in any way relates to any actual testing, or whether or not the tests were "encouraging," Moore Schley distributed a report to its brokers stating that Airlift test results are "quite encouraging" and that "[f]inal [test] results should be available shortly" (Exh. 139). That was not public knowledge on May 1. Regardless of whether or not the statements were true, it appears that Holmes passed on inside information which was used by Moore Schley.

[103] The fact that the "entire fleet" consisted of a total of nine planes (Sovacool, p. 58) was not disclosed. Also, the "quote" by Sovacool was written by Holmes, not Sovacool. (Holmes, p. 1907).

Holmes misrepresented the extensiveness of the testing, and that it was to continue.[104]

In another letter to shareholders on May 18, 1981, Holmes repeats Sovacool's "quote" and states that Sovacool says the device "does more than [was] anticipated" (Holmes, p. 486; Exh. 145). In fact, Sovacool testified that he had no way to anticipate any particular percentage of fuel savings (Sovacool, p. 32).

The Airlift International report was released on July 14, 1981 and was signed by Robert Sovacool, Airlift's Director of Flight Operations (Exh. 1039). Holmes drafted both Sovacool's forwarding letter and the report, and Sovacool signed them (Holmes, pp. 1911-1912; 1914). Holmes can't point out any changes made by Sovacool (Holmes, p. 1915). Holmes had first received the report in June (Holmes, p. 1911). This report, which Holmes calls the "Airlift test package" (Holmes, p. 1913) was the report which Holmes sent to other airlines (Holmes, pp. 1912-1913).

On July 24, 1981 Holmes sent *another* letter to shareholders extolling the Airlift test results (Holmes, p. 517;

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[104] Neither Aero Systems nor Holmes have produced any "test" results, raw data, calculations, compilations, analyses or other documents to back up the Airlift "tests". Sovacool says they were given to Aero Systems (Sovacool, pp. 83-84; 87; 104-105). The documents Sovacool says were given to Aero Systems were not produced by Aero Systems in this litigation despite repeated efforts to get them (Taylor Decl. ¶6). The fact that documents of such obvious importance to Holmes were not produced raises serious questions not only as to the validity of any interpretation of their results, but of their very existence.

Exh. 149). He states that "even though Airlift temporarily ceased operations prior to collecting sufficient data . . . their best estimate is that the final results . . . could reflect fuel savings in excess of 10% . . . " Holmes does not tell his shareholders that Airlift went bankrupt in June, 1981 (Sovacool, p. 8), that after bankruptcy was filed, the aircraft (with the CD-3000 on it) was repossessed and when Airlift got it back, the CD-3000 was gone (Sovacool, p. 39). Holmes says that the tests are "expected to generate immediate sales" to operators of DC-8-63's (Airlift's type of craft).[105]

Further, the Airlift report itself, approved by Sovacool but written by Aero Systems (Sovacool, p. 115; Exh. 1039),[106] Holmes admits writing most of the report (Holmes, p. 1906).

The report clearly states that 2% of the alleged fuel savings is speculative because tests "were interrupted" before comparative calculations could be made (Exh. 1039, p. 001 01592) and that the total resulting savings would be "*between* 4% and 6%" (*Id.*) (emphasis added),

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[105] Note that several DC-8-63 operators were unable to use the CD-3000 to achieve maximum specific range, because instability resulted, forcing the pilot to burn additional fuel to regain stable cruise conditions. (*See, e.g.*, Exh. 3884). Further, by December, 1987, only one CD-3000 was sold to be installed in a DC-8-63 (Exh. 5284).

[106] Holmes admits that the Airlift report itself was *not* sent to shareholders (Holmes, p. 1966).

not that they would be "in excess of 6%" as he later tells his shareholders.[107]

Against this storm of hyperbole and unsupported representations by Holmes of the "fuel percentage savings" to his shareholders and the stock buying public, one must measure what Aero Systems *really* believed the CD-3000 could do.

On July 1, 1981 George Nelson, the recently hired Vice-President, Fuel Computer Marketing, who had the primary responsibility for the world-wide marketing of the CD-3000 (Exh. 5242), sent letters to Japan Air Lines, Gulf Air, Dan Air Service, Cathay Pacific Airways, All Nippon Airways, Air France, Muse Air, Deutsche Lufthansa, Sudan Airways, Transavia Holland and UTA guaranteeing *only* 2% fuel savings by use of the device (Exhs. 3848). Thus, what Holmes was telling the stock-buying public and what Aero Systems was telling those who were sophisticated in the business were two entirely different things.

4. An Aero Systems Corporate Officer Resigned Because of the Press Releases.

The effect of what Holmes and Vigman were putting out was not only felt by the public. George Jackson, with

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[107] Holmes' obsession with "percentage of fuel savings" is not to be underestimated. According to this [sic] own representations of the size of the market – 30 billion dollars – a one percent reduction in fuel costs, equals 300 million dollars! Thus, a misrepresentation of only 1% to his shareholders and the public is not a *de minimus* representation.

the company since March of 1978, and Secretary and Controller of Aero Systems, who reported to Holmes (Jackson, pp. 6-7), resigned on September 26, 1980 (Exh. 1) because of what was going on.

Holmes was the one in the company who made contacts with Aero Systems marketmakers (Jackson, p. 7). Holmes prepared and issued press releases (*Id.*, p. 15). Shortly after the CD-3000 was acquired, the flavor of the press releases changed from the prior years he was there (*Id.*, p. 18). They became overly optimistic (*Id.*, and p. 29). Jackson became concerned about the press releases and projections by Holmes (*Id.*, pp. 14-15; 17).

Jackson became so concerned that he consulted Aero Systems' SEC counsel (*Id.*, p. 14). Jackson told the SEC attorney that Holmes had "gone off the deep end" and that Aero Systems was a "paranoid company" (*Id.*, pp. 29; 31; Taylor Decl. ¶5). The company counsel also expressed concern about the press releases (*Id.*, p. 15).

Jackson then, without Holmes' knowledge (*Id.*, p. 20), consulted independent SEC counsel (*Id.*). They told Jackson that he "could go along with what's happening and ignore it, or . . . resign . . . " (*Id.*). He resigned (*Id.*, p. 21) because his concerns were so great he felt he had to remove himself from the source of the problems (*Id.*, p. 26).

Jackson was "nervous that the stock was going up and it was all, I thought, from the press releases . . . " (*Id.*, p. 23) "directly related to the fuel management computer" (*Id.*, pp. 36-37). The press releases were tied in with the stock and he was nervous about those press releases going to the public (*Id.*, p. 48). "The stock rose

fairly rapidly in a short period of time. . . . (Aero Systems') earnings weren't there to support that kind of rise and in (Jackson's) opinion it was all based upon the press releases issued regarding the potential future profits of the fuel management computer, not on current profits" (*Id.*, pp. 41-50). The Aero Systems "stock price was not justified by the earnings" (*Id.*, p. 48). Although he wouldn't admit in his deposition that he had said it, Jackson considered the CD-3000 "a gimmick" (Taylor Decl. ¶5).

Jackson did discuss his concerns and the press releases with Holmes "a couple of times" (*Id.*, p. 44) but felt he wasn't "going to be strong enough to influence him in these matters and that's why I sought individual counsel" (*Id.*, p. 25).

L. HOLMES PARTICIPATED IN AND ASSISTED IN THE BUNNINGTON STOCK MANIPULATION

Holmes was a direct participant of the Bunnington stock manipulation, and aided and abetted that manipulation.[108] It was done by Holmes through Lugo and Moore Schley, both of which had so greatly benefited Holmes and Aero Systems.

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[108] It is the opinion of John Torkelsen, one of plaintiffs' experts, that the stock of Bunnington was manipulated (Torkelsen Decl. ¶22).

1. Holmes Invested Heavily in Bunnington Through Private Transactions

Aside from the transactions between Holmes and Bunnington set forth above, and his relationship with the Bunnington principals, Holmes was familiar with Bunnington and was a substantial shareholder of Bunnington.[109] Holmes received Bunnington Annual Reports and shareholder letters (Holmes, p. 996).

As set forth above, Bunnington was formed in 1969 and a portion of its stock was distributed to public shareholders of Corporate Enterprises through a "spin-off."

In addition to the Bunnington stock Holmes received by virtue of Holmes' ownership of Corporate Enterprises, Holmes purchased 20,000 shares of Bunnington stock through a private placement in 1969. The purchase price for the 20,000 shares was $50,000 (Exh. 3986).

In September of 1979, Holmes purchased a convertible debenture from Bunnington for $100,000 (Holmes, p. 2880, Exh. 3989). The debenture was convertible into 40,000 shares of the common stock of Bunnington

[109] Holmes also was familiar with Aerosonic. In January, 1980 Ronald Rotstein of Capitalgains spoke with Holmes (Exh. 2631). Rotstein asked Holmes about Aerosonic (Rotstein pp. 46-47). Holmes told Rotstein that Holmes "[k]nows Aerosonics-recording altimeters used in conjunction with collision avoidance systems (CAS) *have the capability to drastically reduce air crashes*" (emphasis added), but told Rotstein "no direct quote here" (Rotstein, pp. 46-47). It is this "CAS" device – again a gimmick that could *not* "drastically reduce air crashes" as Holmes misrepresents – that Aerosonic was hyping to push its stock price up.

(Holmes, p. 994). Holmes converted the debenture to stock in July of 1981, just prior to the collapse of the market price for Bunnington stock (Exh. 3863).[110]

Holmes asserts that he purchased additional stock of Bunnington on October 20, 1980 through a private placement (Holmes, pp. 2864-2865; 2046-2047; Exhs. 3863, 3987). The sale actually took place on November 11, 1980 (Exh. 3987). Holmes paid $150,000 to acquire the 50,000 shares of Bunnington (at $3.00 per share) (Holmes, p. 2864-2865, Exhs. 3863, 3987). On the following two days, Holmes sold 50,000 shares of Aero Systems stock through Moore Schley, more than enough to pay for the Bunnington securities (Exh. 3863).[111]

[110] This clearly provides a strong motive for Holmes to assist in the Bunnington manipulation. Holmes' cost basis was $2.50 per share; at the time he converted, Bunnington's price was 10 5/8 per share (Foley Decl. ¶¶91-92). The two year waiting period under Rule 144 was to expire in September 1981. Holmes only missed by two months.

[111] Holmes' 144 sale of 50,000 shares of Aero Systems stock through Moore Schley on November 11 and 12, 1980 (Exh. 3863), not only made Holmes a whopping profit, and provided money to fuel the Bunnington manipulation, but also represents Holmes' reward to Moore Schley for a job well done. As Sayegh of Moore Schley testified "[a]ny trading firm on Wall Street obviously tries to get the flow of stock . . . There is a constant competition amongst all firms to get the buyers and the sellers" (Sayegh, p. 68). When Holmes initially decided to sell 50,000 Aero Systems shares, he was going to sell 25,000 to Moore Schley and 25,000 to Wheat First (Holmes, p. 967, ll. 12-15; Exh. 171). But Holmes "changed his mind" and directed that all 50,000 shares were to be sold to Moore Schley (Holmes, p. 967; Exh. 172).

2. Holmes Actively Traded Bunnington

In addition to Holmes' purchase of Bunnington stock and the debenture through private transactions, Holmes traded heavily in Bunnington stock to assist Lugo and Bunnington in the manipulation of Bunnington stock.

During the period of time from September 3, 1977 through May 20, 1981, Holmes purchased 61,900 shares of Bunnington on the open market. The aggregate cost of the purchase was $364,875.00 at an average cost of $5.79 per share. A total of 60,900 of the shares purchased were subsequently sold for total proceeds of $357,203.57, at an average price of $5.87 per share (Foley Decl. ¶ 90).

Holmes purchased 45,900 of the Bunnington shares through FSSC in twelve transactions (Foley Decl. ¶ 93). Holmes received preferential treatment from FSSC in connection with his purchases, at prices lower than the lowest NASDAQ reported asking price. This preferential pricing amounted to a total of $13,237.50 to Holmes' benefit (Foley Decl. ¶ 94). With the exception of one transaction, these securities were sold through broker-dealers other than FSSC in sixty-six separate transactions (Foley Decl. ¶ 95). This created the appearance of market activity, which had the natural result of artificially maintaining or raising the market price of the stock (*See* Foley Decl. ¶ 103).

Holmes' purchases assisted Lugo in creating market demand for the securities and controlling the public float of Bunnington stock (Foley Decl. ¶ 99). Nine out of twelve of Holmes' purchases between May 31, 1979 and May 20, 1981 represented more than 51% of NASDAQ's average daily volume (Foley Decl. ¶ 98). Further, between

March 1, 1981 and July 24, 1981, Holmes was the largest buyer of Bunnington stock from FSSC, for 10,000 shares (Foley Decl. ¶ 99). This occurred at a time when there was no active market for Bunnington stock (Foley Decl. ¶ 102).[112] During the same period, the largest seller of Bunnington stock was Vigman, selling 17,000 shares under Rule 144. (Foley Decl. ¶ 100)

Holmes' profit from these transactions amounted to only $363.48. It is a triable issue of fact whether or not purchases at FSSC and subsequent sales were made for the purpose of assisting Lugo with the domination and control of the float of Bunnington common stock (Foley Decl. ¶¶ 98, 99, 124).

3. Holmes Actively Promoted Bunnington

Holmes tried to involve Porter, LeVay & Rose with Bunnington. Holmes asked Porter to represent Bunnington and asked PLR to send its materials to Bunnington (Porter, p. 49, ll. 9-15). Porter, wisely, decided against it (Porter, p. 49, ll. 18-19).

Holmes also promoted Bunnington to Herb Sheidy, the analyst with Moore Schley (Sheidy, pp. 128-129). Holmes asked Sheidy if Moore Schley would be interested in looking at Bunnington with a view toward making a recommendation of Bunnington stock to their customers or making a market in the stock (Sheidy, pp.

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[112] During the March 1 through July 24, 1981 period, a total of 145,000 shares of Bunnington were sold by FSSC customers. Only 47,000 shares were purchased (Foley Dec. ¶¶ 99, 100).

129; 144).[113] Holmes recommended that Moore Schley make a market in Bunnington (Holmes, p. 983). Holmes told Moore Schley about Universal Silicon[114] and its connection with Bunnington (Holmes, p. 991).[115]

On May 6, 1981, Bunnington issued an announcement of its acquisition of Universal Silicon (Exh. 1683). In the release, Bunnington touted the "anticipated" success of the new subsidiary's polychrystaline silicon process.[116]

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[113] Bunnington only had 6 market makers in may [sic] – June, 1980 (Foley Decl. ¶ 135). There was little market activity in Bunnington stock at that time (Foley Decl. ¶¶ 102, 103). Holmes was attempting to create a market in Bunnington for two reasons: to protect his own economic interest and to protect that of his friends at Bunnington. Who better should Holmes attempt to entice but Moore Schley which had done so well by him in the past.

[114] Holmes also discussed Universal Silicon with Vigman (Holmes, p. 993).

[115] Universal Silicon was supposed to develop low cost "electronic grade" silicon, a material used in computer chips and transistors (McNeil, pp. 873-875). This is another in the long line of "products" that were guaranteed to draw the attention of the stock-buying public; another "gimmick." Universal Silicon predictably failed and by January 1986, the operation was shut down (McNeil, p. 875-876).

[116] Bunnington prepared a release on May 5, 1981 which was identical to the May 6, 1981 release (Exh. 1682). McNeil testified that he couldn't recall the reason for the duplication, but that he didn't believe Bunnington had sent out two identical releases, and that it was not a draft of the May 6, release (McNeil, pp. 891-893). However, since Holmes bought 5,000 shares of Bunnington on May 5, 1981 it is a reasonable inference that he either did so with insider information or did so as

(Continued on following page)

Holmes telefaxed Sheidy of Moore Schley a copy of the May 6, 1981 Bunnington press release to help create interest in Bunnington (Sheidy, pp. 132-134; Holmes, pp. 996-998; Exh. 187).

The May 6, 1981 press release was false and misleading. It failed to disclose: (a) that the commercialization of polychrystaline silicon was a "high risk" venture; (b) that Bunnington lacked the capital to fund Universal Silicon so a partnership including Vigman, Diamond and McNeil was established to infuse capital; and (c) that the polychristaline silicon process was subject to potential claims by Aero Chem, claims that later resulted in a lawsuit over the rights to the process (McNeil, p. 868; Exh. 6739; Gould, pp. 8-12; 42, 43).

Following receipt of the Bunnington press release Holmes continued to actively promote Bunnington to Moore Schley. Sheidy and Holmes had other discussions regarding Bunnington, and Holmes requested that Moore Schley look at Bunnington (Sheidy, pp. 141-142). Figliozzi also had conversations with Holmes regarding Bunnington (Figliozzi, p. 324-325). Further, Sheidy, Figliozzi, Augus and Sayegh (all of Moore Schley) had dinner with Holmes and McNeil in New York (Sayegh, p. 54).

Holmes again spoke with Sheidy on June 19, 1981 regarding Bunnington and its acquisition of Universal

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(Continued from previous page)

a result of an agreement with his friends to delay the release so he could purchase before the release had its desired effect. The price of Bunnington rose from 11 1/4 bid on May 5, 1981 to 11 7/8 bid on May 7, 1981 (Foley Decl. ¶ 136).

Silicon. During the conversation Holmes provided Sheidy with additional information concerning the silicon operation and related to Sheidy information concerning the availability of funds from Monsanto Corporation which might have an impact on Bunnington's prospects (Sheidy, pp. 143; 147; Exh. 183).

Holmes' interest in promoting Bunnington stock appears to be related to his relationship with Vigman, Diamond and McNeil rather than an interest in the company's product. Holmes testified that he liked the people at Bunnington and liked the fact that Vigman was associated with them. (Holmes, p. 984).

M. HOLMES' EFFORTS TO SUPPORT THE PRICE OF BUNNINGTON STOCK AFTER THE COLLAPSE IS EVIDENCE OF HOLMES' PARTICIPATION IN THE SCHEME

On July 21, 1981, FSSC and Sebag ceased making a market in the Bunnington stock, due to their capital deficiencies. The closing market price for Bunnington was 10 3/8 bid/10 5/8 ask on July 20, 1981. The market price of Bunnington had dropped to 3 bid/3 1/2 ask by July 27, 1981 (*Id.*).

Holmes again stepped into the breach and "paid" his friend Vigman. He made a substantial effort to prop up his friends' company, and maintain the price of Bunnington's stock.

Holmes purchased 48,000 shares of Bunnington through Moore Schley on July 28 and 29, 1981 (Exh. 3863, 1. 107, 108). Further, during the period between July 28, 1981 and November 13, 1981 Holmes purchased 172,137

shares of Bunnington stock on the dates and at the prices indicated at ¶¶ 115-117 of Foley's Declaration. This was a continuing effort by Holmes to maintain Bunnington's stock price (Foley Decl. ¶ 119).

Further, in order to be able to invest so heavily, Holmes *borrowed* $600,000, secured by 528,000 shares of Holmes' Aero Systems stock, specifically to acquire Bunnington stock and to retire a $100,000 loan at the bank (Holmes, pp. 1031-1034; 3199; Exhs. 5279, 5280).

Finally, Holmes believed that a public company should have the broadest stockholder base possible (Holmes, pp. 2614, 2618). In a transaction that defied the logic of at least one broker,[117] in July 1983, Holmes caused Aero Systems to distribute Bunnington stock which he had sold to Aero Systems shareholders (Holmes, p. 2763; Exh. 3968) which numbered over twelve thousand (Exh. 3968). By his acts, he again "paid" his friends at Bunnington by enlarging Bunnington's shareholder list to at least the number of Aero Systems shareholders.

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[117] Lawrence Waters, Vice President and retail broker at the Investment Corporation of Virginia, spoke to Holmes after the release of Aero Systems' 1983 Annual Report. (Waters, p. 64; Exh. 5261) Waters noticed Holmes "owned a big position in Bunnington." Waters "asked [Holmes] what type of stocks had he bought. And he said he had just bought 150,000 shares of Bunnington and it was a good one to own" (Waters, pp. 64-65). Waters followed Bunnington stock for a year but, "it never moved, never, it didn't move an eighth. In fact, it went down . . . Maybe a year or so later . . . all of a sudden it started to pick up steam" (Waters, p. 123). Bunnington climbed to around

(Continued on following page)

N. HOLMES PARKED BUNNINGTON STOCK WITH LUGO

On May 18, 1981, FSSC's inventory reached an all time high of $688,378. Included in FSSC's inventory were 19,208 shares of Bunnington common stock with a market value of $235,298. At this level of inventory, FSSC's Net Capital was deficient by $136,222 (Foley Decl. ¶ 46).

In May of 1981, all trades through May 21st were included in FSSC's net capital computation for its monthly Net Capital Report to the NASD (Foley Decl. ¶ 52).[118]

(Continued from previous page)

six dollars a share (Waters, p. 118). When Holmes told Waters that Aero Systems was going to pay a dividend of Bunnington stock, Waters said "that knocked me for a loop . . . you're giving us a piece of nothing thats going to cost people more to sell it than its worth. And he said, "well, we've decided that's what we're going to do" (Waters, pp. 117-118); "He seemed to be giving it away, flat giving his stock away" (Waters, p. 134). At the time Aero Systems paid the dividend of Bunnington, the Bunnington stock was selling at six dollars a share (Waters p. 118). Waters testified that [Holmes] had a three point profit. "He had a four hundred thousand dollar profit. He just could have sold it on the open market, and he was giving it to the shareholders at three, but at what benefit, if he wasn't receiving any cash from it? And I couldn't figure out why he was giving it away" (Waters p. 135).

[118] FSSC reported its Net Capital to the NASD on a monthly basis, using the last Friday settlement as the closing date for financial statement and net capital computation. Trades as of May 21st were [sic] be settled on May 29th, allowing five business days and one extra day to allow for the Memorial Day holiday, pursuant to the NASD Uniform Practice Code Paragraph 3504, Section 4 (Foley Decl. ¶ 52).

In order to create the appearance of compliance with the Uniform Capital Requirements under SEC Rule 15C-3-1, Lugo "parked" securities with customers to conceal the true state of its inventory positions from the NASD (Foley Decl. ¶¶ 47, 51).

Holmes' account at FSSC was one of the customer accounts used for parking securities that were properly attributable to FSSC's inventory. On May 20, 1981, an order to purchase 5,000 shares of Bunnington stock was entered in Holmes' account. The transaction reflected a purchase price of $61,250.00, with payment to be made by delivery to Holmes' bank, First Southeast National Bank of Miami Springs, Florida (Foley Decl. ¶¶ 49, 55, 63).

The transaction reduced the value of the Bunnington inventory by $61,250, thereby reducing the amount of capital required by the SEC. However, this was not a *bona fide* transaction (Foley Decl. ¶ 51, 58).

On May 29, 1981, an order to sell 5,000 shares of Bunnington was entered in Holmes cash account at FSSC, for a sale price of $61,875 to be settled on June 5, 1981 (Foley Decl. ¶¶ 53, 54).

On June 1, 1981, four days before settlement of the May 29 sale of the 5,000 Bunnington shares, FSSC made a prepayment of $61,875 to Holmes. This occurred prior to Holmes' payment for the purchase of the securities on May 20, 1981 (Foley Decl. ¶ 53, 54).

To make the prepayment on June 1, 1981, FSSC had to borrow funds from SCCP. An employee of FSSC, Robert Reber, delivered the check which Holmes endorsed over to his bank. On the same day, Holmes' bank wired

$61,250 to SCCP to be credited to the FSSC loan account for payment of the stock originally purchased on May 20, 1981. Ordinarily, payment would be made by a draft sent to FSSC's own bank to be credited to FSSC's bank account (Foley Decl. ¶¶ 53, 54).

Through these transactions, Holmes "paid" for the 5,000 Bunnington shares with the FSSC's funds. This is known as a "free ride", and is expressly forbidden by a SEC Rule. Further, FSSC's inventory of Bunnington stock was increased by 5,000 at a value of $61,875 (Foley Decl. ¶¶ 61, 62).

The shares sold on May 29, 1981 (settling on June 5, 1981) appear to be the same ones purchased on May 20, 1981, although Holmes claims that they are not (Holmes, p. 2842). Holmes claims that the shares sold on May 29, 1981 were purchased on May 5, 1981 through Lugo in Holmes' DVP account at FSSC, and claims that they were delivered to cover the May 29, 1981 sale (*Id.*).

However, it does not matter which certificates Holmes delivered to cover the May 1, 1981 sale, since even if the certificates for the May 5 purchase were delivered, it still does not change the effect that the May 20, 1981 purchase had to mask FSSC's net capital deficiency. The transaction was a park, particularly because the sale takes place soon after the May net capital reporting period, and because the proceeds from the May 29, 1981 sale (paid in advance) were used to pay for the May 21 purchase (Foley Decl. ¶ 58, 61, 62).

The following chronology of the sale and prepayment on June 1, 1981 shows the coordination between Lugo

and Holmes to execute the "parking" transaction, while maintaining the appearance of legitimacy:

a. Holmes endorsed the check;

b. Reber hand delivered the check to Holmes' bank on June 1 for deposit;

c. The bank stamped the check and sent it through the clearing house on June 1;

d. The bank wired to SCCP the $61,250 needed to pay for the DVP purchase on June 1 to credit the FSSC loan account;

e. FSSC borrowed $125,000 on June 1 to cover the check to Holmes;

f. Holmes paid for the stock purchase after he received the prepayment, in effect, using FSSC's own funds to pay for the purchase;

g. Holmes sold 53,900 shares on 64 different trades between March 2, 1979 and June 16, 1981. The 5,000 Bunnington share sale on May 29, 1981 was Holmes' only sale through FSSC during the March 2, 1979 to June 16, 1981 period (Foley Decl. ¶ 57, 63).

O. HOLMES AND AERO SYSTEMS PARTICIPATED IN DASH STOCK MANIPULATION THROUGH THE CASCADE DATA DEALERSHIP AGREEMENT

Holmes' involvement with Blumenthal stretches back to the days of J. C. Roberts. Blumenthal was also a shareholder in DCS Financial, and received shares of Aero Systems stock when DCS merged with Aero Systems Avionics.

In 1977, Blumenthal joined with Dash Industries, Inc. (Exh. 4881), a Miami-based manufacturer of wall coverings and draperies (Blumenthal, p. 320). Dash Industries, until that time, had been controlled by Philip Dash, and his son, Jay Dash (Exh. 4882).

In 1980, Blumenthal was introduced to Robert McAndrews, president of Cascade Data, a computer manufacturer doing business in Michigan. Blumenthal and Robert McAndrews ("McAndrews"), Cascade's president, agreed that Cascade would merge with Dash, and receive a cash payment of $400,000.00 and, additionally, McAndrews was to receive 925,000 shares of Dash common stock (Dash RFA 54). Subsequently, McAndrews learned that Blumenthal wanted to have access to "a team of stockbroker marketers" . . . "until the insiders [could] sell enough stock." (Exh. 2952; McAndrews, pp. 57-64, 4/16/88)

FSSC was a market-maker in Dash stock (Lugo, p. 440; Blumenthal, pp. 407-408). Like Aero Systems, the price of Dash stock rose based upon false and misleading press releases. In Dash's case, the press releases, later repeated in various news articles, contained false financial information (Exhs. 515; 414; 4890; 4893; 643; 639) and information about computer products which were either misrepresented or didn't exist at all (Exhs. 494; 4918; 638; 645 and 515; Koscic, pp. 78-80; 84-89).[119]

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[119] For example, C. Stephen Carr (Mr. Carr is a computer expert; his qualifications are found at pp. 9-19 of his deposition.) testified that Dash published misleading information about the identity of Cascade's competitors (Carr, p. 128), Cascade's marketing plan (*Id.*, pp. 131-132), and that Cascade was a designer and manufacturer of main frame computers (*Id.*, p. 56).

One element in Dash's scheme to manipulate the price of its stock was a public relations campaign regarding the number of retail outlets that would sell Cascade Data computers. Repeatedly, Dash publicly stated that Cascade Data would have 1,000 retail outlets for its product (Exh. 4918).[120]

In 1980, Bob Holmes of Aero Systems met with Blumenthal and McAndrews (Blumenthal, pp. 263). As a result of their meeting on October 16, 1980, Aero Systems, an airplane parts business, became a retail computer outlet for Cascade Data and Dash Industries (Ashton, pp. 247-248; RFA 923). Dash seized the opporutnity to hype its growing network of computer dealers (Exh. 1407).

Less than eight months later, on June 12, 1981, Aero Systems cancelled the dealership agreement with Cascade Data stating, among other things, that Cascade computer components were so common in the computer industry that Aero Systems could build it themselves (Ashton, p. 248; RFA's 927, 928, 930).

Aero Systems' "dealership" purchased only one computer, and had no sales (Exh. 3313). These facts result in a compelling inference that the only purpose for the Aero Systems dealership was to create public exposure and initial media coverage for both Dash and Aero Systems.

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[120] Carr analyzed the business and operations of Cascade Data and opined that, given the company's capitalization, it was virtually impossible for Cascade Data to establish 1,000 retail outlets for its product (Carr, p. 122).

P. THE EFFECT OF THE MANIPULATIVE SCHEME ON THE CAPITAL OF FSSC AND SEBAG

1. FSSC – March 1981 to July 1981

At the end of March 1981, FSSC had a capital deficiency. Although FSSC had net capital in excess of $67,841 – there was a deficiency of $120,273 in the Customer Reserve Account. Since there was only $16,000 in the FSSC checking account, Lugo should have either sold inventory to raise cash to meet the requirement or obtained a major infusion of capital from FSSC's principals. Lugo did neither (Foley Decl. ¶¶ 32, 33).

Between March 27, 1981 and April 24, 1981, FSSC's inventory value more than doubled, from $182,000 to $415,000. During this time, FSSC's capital declined 40% for a net capital deficiency of $16,625, and FSSC's Customer Reserve Account deficiency grew to $199,793. (Foley Decl. ¶ 32-34).

During this time period, Vigman made available to Lugo proceeds generated from the sales of Nettie Vigman's inflated Aero Systems stock to finance FSSC's continued operation, and to increase FSSC's inventory of the target securities. The credit balance in Nettie Vigman's account effectively provided Lugo with an interest free loan of more than $220,000 in April 1981 (Foley Decl. ¶¶ 27, 34).

By the end of April 1981 Lugo was aware of FSSC's capital deficiency problem. He then ceased withdrawing his monthly compensation from the firm. Lugo used his salary and trading profits to relieve FSSC's deteriorating financial condition. At the close of the April reporting period for net capital, Lugo had to pay Nettie Vigman her

credit balance. In order to do this, Lugo borrowed $100,000 from SCCP, and to conceal FSSC's financial condition, the loan was not recorded in FSSC's Customer Loan Account (Foley Decl. ¶¶ 27, 39-42).

By May 29, 1981, FSSC had a net capital deficiency of $102,165. FSSC's inventory, adjusted to correct for securities parked by Holmes and others totaling ($213,125) was $619,000. The deficiency in FSSC's Customer Reserve Account was now $420,917. Again, to pay Nettie Vigman, Lugo borrowed $300,000 from SCCP, which was not reported in FSSC's Customer Loan Account (Foley Decl. ¶¶ 35, 39, 47).

As a result of the "parks" in the accounts of Holmes and others, Lugo was able to create the appearance of capital compliance and FSSC's financial deterioration was shielded from the NASD. (Foley Decl. ¶ 36-38, 43)

Had FSSC ceased doing business in May 1981, FSSC's calculated losses would have been $779,594. However, by FSSC continuing in business through July 24, 1981, FSSC's losses increased to $2,634,976 (Foley Decl. ¶¶ 83-86).

Without Holmes' participation in the May 1981 parking transaction, FSSC could not have created the appearance of net capital compliance. The concealment of FSSC's true financial condition allowed Lugo to continue in business, and as a result, the financial condition of FSSC worsened. FSSC's continued operation after May 29, 1981, permitted the following to take place:

a. FSSC continued to build up its inventory in Bunnington and Aerosonic stock;

b. FSSC's Customer Loan Account increased by $1,000,000 at SCCP;

c. FSSC's net capital deficiency and related losses increased by more than $1.8 million; and

d. FSSC's trading losses and reserve deficiency increased from $779,594 (as of May 29, 1981) to $2,634,976 (as of July 24, 1981) (Foley Decl. ¶¶ 81, 86).

2. SEBAG. – May 29 to July 27, 1981

On May 29, 1981, Sebag had total capital of $1,900,000. There was only $110,000 of Aerosonic, Bunnington, Dash and Osrow Stock in inventory (Foley Decl. ¶ 64). However, during June and July 1981, Garrity purchased more than $7,000,000 worth of these stocks from FSSC and other market makers to stabilize the market price of the securities. Of this amount, 95% of the securities purchased were in Bunnington, Aerosonic and Osrow. These securities were sold to the accounts of Garrity, his family members, and other customers. However, 46% of these purchases were ultimately never paid for and were purchased into Sebag's inventory pursuant to Regulation T at a cost of $3,300,000 (Foley Decl. ¶¶ 65, 66, 67).

Of the purchases paid for, a substantial number were financed through margin accounts. These margin purchases increased Sebag's bank loans, for which Aerosonic, Bunnington and Aero Systems stock were pledged as collateral. Losses resulting from a decline in the value of pledged securities exceeded $5,000,000 when the price of Aerosonic dropped to $5.00 and Bunnington dropped from $12.00 to $2.50 by July 27, 1981 (Foley Decl. ¶ 70 72)

Had FSSC ceased operations at the end of May 1981 instead of July 24, 1981, the damages to both FSSC and Sebag would have been substantially less (Foley decl. ¶ 83-86). If FSSC had ceased trading in May 1981, Sebag would not have collapsed (Foley Decl. ¶¶ 64-69).

3. SIPC's liquidation of FSSC and Sebag

Pursuant to SIPA, liquidation proceedings were initiated against FSSC and Sebag on July 24 and July 27, 1981, respectively. Under the provisions of SIPA, SIPC paid a total of $12,453,475.26 to the Trustee of FSSC and Sebag.

The acts of Holmes as set forth above led to and were a substantial contributing factor to the losses and damages incurred by SIPC and the two trustees.

III

CONCLUSION

Holmes' activities as described in this memorandum are intentional and criminal, and were committed by Holmes not only for his own enrichment but to aid and abet the enrichment of Vigman, Diamond, Lugo, Garrity, Blumenthal and others.

Each historical relationship, each act and each profiting illustrates that Homes' conduct must, at the very least, be weighed by a jury. Homes did not act alone, and he didn't profit alone, as counsel for Holmes would have this Court believe. Holmes and the others, acting in concert since as early as 1966 must now sit in concert before a

jury so that their acts can be judged. Homes motion must be denied.

Dated:
September 20, 1988

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PROOF OF SERVICE

I, the undersigned, declare that I am, and was at the time of service of the papers herein referred to, over the age of 18 years and not a party to the action. I am employed in the County of Los Angeles, State of California, in which county the within-mentioned mailing

occurred. My business address is Sheppard, Mullin, Richter & Hampton, 333 South Hope Street, 48th Floor, Los Angeles, California 90071. I am familiar with the regular mail collection and processing practices of Sheppard, Mullin, Richter & Hampton for correspondence deposited for mailing with the United States Postal Service. I served the following document(s):

STATEMENT OF BACKGROUND AND FACTS

by placing a copy in a separate envelope for each addressee named hereafter, addressed to each such addressee respectively as follows:

Please see attached Service List

I then sealed the envelope with postage thereon fully prepaid and deposited it for collection and mailing via the United States Postal Service on September 21, 1988. The envelope was sealed and deposited in accordance with the ordinary business practices of Sheppard, Mullin, Richter & Hampton for mailing on September 21, 1988

I declare under penalty of perjury under the laws of the State of California and the United States of America that I am employed in the office of a member of the bar of this Court at whose direction the service was made and that the foregoing is true and correct.

Executed on September 21, 1988, at Los Angeles, California.

/s/ Laura Lawrence

Z0531030.E1

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No. 90-727

In The

Supreme Court of the United States

October Term, 1990

ROBERT G. HOLMES, JR.

Petitioner,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

JOINT APPENDIX VOLUME II

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

HONORABLE A. WALLACE TASHIMA,
JUDGE PRESIDING

SECURITIES INVESTOR PROTECTION CORPORATION, et al., Plaintiffs, vs. SEYMOUR VIGMAN, et al., Defendants. AND CONSOLIDATED ACTIONS.	CERTIFIED COPY Case No. CV-83-4742-AWT Consolidated Cases CV-83-4742-AWT (TX) CV-83-5674-AWT (TX) BK NO. SA85-00083-PE ADV. NO. SA85-0138-PE

REPORTER'S TRANSCRIPT OF PROCEEDINGS

LOS ANGELES, CALIFORNIA

MONDAY, OCTOBER 24, 1988

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Official Court Reporter
429-D U.S. Courthouse
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[p. 7] LOS ANGELES, CALIFORNIA; MONDAY, OCTOBER 24, 1988; 1:30 PM

THE CLERK: Item number 17, CV-83-4742-AWT: SIPC, et al. versus Seymour Vigman, et al, consolidated with CV-83-5674.

THE COURT: I am not going to have anybody enter their appearance. If you want to be shown on the minutes as having appeared, you can leave you name with the clerk; and as far as I am concerned, the only people who are here on the argument are just the people who made the motion or opposed them; and then on that basis, first, the plaintiffs filed something called a surreply or attempted to file something called a surreply to the Holmes' reply, and since it's really just a matter of arguing the evidenciary rulings, I am going to ask the clerk to have this filed.

I haven't done it as I customarily do on the morning calendar, indicated a tentative ruling but I will do so now, and this is not addressing the motion to continue the pretrial conference. This is just on the motion for summary judgment. Let's see.

Defendant Holmes has filed a three-part motion, or three separate motions for summary judgment on the causation, on standing, and on the RICO claim.

As I understand it, the first two motions are directed against all plaintiffs, except the class [p. 8] plaintiffs; and the last motion, the RICO motion, is directed to everybody; is that right?

MR. GRAHAM: Robert Graham on behalf of the trustees.

The standing motions as to the securities claims is directed solely –

THE COURT: Excuse me. SIPC?

MR. GRAHAM: SIPC.

THE COURT: I agree with that. All right.

In other words, there is a joinder in this motion by – I forgot. I will call it the Holmes Corporation, for lack of a better word, although I don't mean to draw any legal conclusions from that.

MR. SAMET: It's called Aero Systems.

THE COURT: By Aero Systems.

Here's my view of the Aero Systems joinder: One, I am not going to hear any separate argument on that. But I am going to treat it this way: As far as the objection of the plaintiff is concerned, plaintiff may be correct: In certain respects, it may have argued the motion differently if the joinder has been timely, but I don't think it makes any difference because I am going to limit any affect of this motion on Aero as follows: To the extent any matter is deemed to be established without controversy, I believe it applies to Aero as well; but I [p. 9] don't think a separate judgment can be entered in any event in Aero's favor because even assuming Holmes is correct all the way down the line, my understanding is that the plaintiff's case against Aero is also predicated on activities of Diamond so it wouldn't remove the claim anyway; so there would be no judgment on any claim.

That's how I am going to approach the joinder.

Now, this is my feeling on the motions of Holmes. I believe on the RICO claims – to me that's the easiest one. On the RICO claims, I believe that there are issues of fact raised so that I indicated a probable denial there.

But on the remaining claims, I think my inclination is to grant the motion. I don't known if I can express myself any further. I think the causation claims, it's not so much whether or not there is an issue of fact. It's a question of, I think, attenuation and how far out can you spin the web and still find causation. I think that's almost what it amounts to.

Standing is almost the same thing, except on standing, it appears to me that SIPC has not now shown, as it's required under the Ninth Circuit ruling in this case, that there was some, I don't know what to call it, some wrongful use of the stock.

The only showing is that stock was [p. 10] pledged. It doesn't show if it was wrongful. There is no showing on that.

I think under Celotex now, since that is almost an element of the claim, that at this stage, SIPC has the burden of coming forward with some evidence to support that element of the claim.

So that's sort of the tentative ruling. I think since the matter is largely – well, if it goes into – well, I will hear from Holmes.

Let me put it this way: Just if you want to be heard on the RICO; and then since the tentative ruling is in your

favor, otherwise, then we will get the opposition and give you a chance to reply. How is that?

You want to be heard on the RICO claim?

Mr. SAMET: Just very briefly.

Should I speak from the podium?

THE COURT: I think you should so that the reporter can hear you better.

MR. SAMET: Yes, your Honor.

I think that the same principles which were raised in the causation and standing motions have an impact on the RICO motion and indeed a controlling impact in that if there is no causal connection between the conduct of the Holmes and the demise of the brokerage firm, then the causation element of RICO is missing. I must –

[p. 11] THE COURT: You say – all right. The same causation analysis applies to the RICO claim as it does to the other claim?

MR. SAMET: Right.

THE COURT: Although the analysis is really in terms of, we'll say, security type causation?

MR. SAMET: Yes. Except that if there is no – in effect, if there is no securities claim – the gist of all the claims is if there is no security claims under 10b-5, it seems to me that is also a RICO deficiency and the same applies to standing.

THE COURT: You mean saying that in the sense that there is no predicate act?

MR. SAMET: No, I am not saying there is no predicate act. I am not going to contest Your Honor's ruling that there are issues of fact here.

I am saying the predicate acts are not predicate to the damages. There is no causal connection between what are called predicate acts or acts of racketeering if there are any and the actual damage, the demise of the brokerage firm; and I think the point of causation if it has validity, and I believe it does, has validity not only in the causation motion but the RICO motion as well, and the same for standing and that is even if Your Honor is correct and there could be issues of fact [p. 12] whether there were predicate acts but they are not causely connected and the same for standing.

THE COURT: All right. Thank you.

Who's going to be first up here?

MR. TAYLOR: Can I address the standing and causation issues with respect to RICO, Your Honor?

THE COURT: Yes.

MR. TAYLOR: Stephen C. Taylor of Sheppard, Mullin, Richter & Hampton on behalf of SIPC.

Your Honor, I thought that this might be the issue that the Court wanted to hear. I agree with the Court's tentative ruling.

There is a difference, contrary to what Mr. Samet says, between the standing issues and the causation issues under 10b-5 as opposed to those causation and standing issues under the RICO statute.

The defendants claim that SIPC has to be a purchaser or seller under rule 10B to assert claims under RICO. That's just what he said. That's wrong. I want to point out the case that we have cited in our brief, which is Warner versus Alexander Graham of the 11th Circuit.

There was no such requirement in that case and there was no such requirement for good reason. In Warner there was alleged that defendant Graham had issued a series of false and misleading statements concerning the financial [p. 13] statements of the firm called ESM Broker and the Defendant Graham had participated and abetted in the conspiracy to defraud it.

None of the damages claimed were in connection with the sale or purchase of securities by Warner. Nevertheless, the court flatly stated that the RICO statute has no such court imposed limitation and held that he could state a cause under RICO for damages that he incurred as a result of sales and purchases by others which had the effect of injuring.

Defendants urge the Court to follow the more reasoned view of the Zepkin case in the 4th Circuit.

The Court should not for several reasons. First, Zepkin is easily distinguishable from Warner. Zepkin facts, unlike Warner, involve a matter which really constituted a breach of nothing more than a breach of fiduciary duty. Pure and simple. Never should have been a RICO case in the first place.

The gravamen in Zepkin, unlike Warner where the plaintiffs losses could relate to the sales of securities by others than the Plaintiffs, was merely that plaintiff was

induced to rely upon representation, made advances under those representations.

In Zepkin – Zepkin with these facts, then proceeds to discuss whether or not Congress intended the [p. 14] purchaser-seller restriction to be applied, quote, to a RICO claim based on a 10b-5 violation, end quote.

It first uses the Bernbaum rule as justification for its holding. In other words, it examines the restrictive interpretation of the courts which granted the right of a private party to bring an action under the legislation as to rule 10b which did not grant that right initially, then with reason extends far beyond what the case required, superimposes that restriction over an explicit right granted by congress by its use of the phrase in the RICO statute, "Fraud in the sale of securities."

That's in quotes.

It's just an urge that I quote, "Fraud in the sale of securities," end quote, was not so restricted by congress because it meant the phrase should not be restricted.

The Zepkin court correctly states that congress did not write RICO in a vacuum and indeed it didn't; but yet the Court states that since the vacuum was filled with, quote, hundreds of cases since Bernbaum which followed the Court imposed restrictions on Bernbaum up through Blue Chip Stamp, congress must have meant, quote, fraud under rule 10b-5 when it said, quote, "Fraud in the sale of securities," end quote.

The court says then, quote, "If the Court had [p. 15] intended the drastic result of overturning this consensus, it surely would have done so in a more explicit way."

This to me is tortured logic.

If with all the litigation involving standing under a right explicitly given by congress and when congress explicitly giving a right under RICO, it's much more logical to say that the congress would have said that RICO provided that right by stating that the right existed, quote: For fraud in the sale of securities under 15 USC section 78 JB and rule 10b-5 thereunder. It didn't do that. It used the word "fraud" in the sale of securities.

Now, the Zepkin court states that congress merely intended to expand the range of remedies rather than overturn the settled law.

Well, first, congress overturns law all the time. But in this case when congress clearly expanded the gamut of devices to combat organized crime and which SEDEMA said was to be broadly construed to effectuate its remedial purpose, is it not just as logical to state that the remedial purpose is to stop the kinds of mass fraudulent manipulation cases as in the case at hand.

And can it be interpreted to exclude a party, a private party such as SIPC who have no federal remedy to collect its losses, if congress and the Supreme Court's broad interpretation of RICO is not effected here.

[p. 16] The Zepkin court also asserts the parade of horrors of "what if's" and cites the dangers and vexatiousness of securities litigation as a result by not allowing an action under RICO unless the plaintiff is, quote, a buyer or seller of securities under rule 10b-5.

With due respect to the Court, this is not an excuse to reimpose a court developed restriction on expressed congressional language. We do not have a case here for which the courts need protection.

We are not, as the Court assumes, a plaintiff to be in the absence of the doctrine a, quote, bystander to the securities marketing process awaiting developments on the side lines without risk, end quote.

Rather, SIPC is a private party funded by public members required by law to pay such losses caused by the acts such as those as defendants did herein. There is no danger here as set forth by the Zepkin court.

The examples the court sites relate to causation, not to standing and courts did not ignore the expressed and unfettered language used by congress and take away plaintiff's rights granted by that language.

Indeed, the Ninth Circuit in First Pacific Bank Corp versus Bro, stated there must be, quote, a fraud in the stale of securities, end quote, to proceed under RICO. But the decision does not require that the Plaintiff be a [p. 17] purchaser or a seller.

Had the Ninth Circuit believed as Zepkin rather than Warner, why didn't they simply say that the first Pacific Bank Corp plaintiff wasn't a purchaser or seller under 10b-5. They didn't do that.

They accepted congress' language as it was; i.e., there was not a sale of securities involved in the case.

Further, the Supreme Court is cautioning against this embellishing the language of the statute.

In U.S. versus Lock, 105 Supreme Court 1785, at page 1793 – it's a 1985 case – the Court stated: Nor is the judiciary a license to attempt to soften the clear import of congress' chosen words, whatever the courts beleive [sic] those words to be, would lead to a harsh result," with citations.

On the contrary, deference to the supremacy of the legislature as well as recognition that congress can typically vote on the language of a bill generally require us to assume that, quote, legislative purpose is expressed by the ordinary meaning of the words used, end quote, with citations.

Quote, going down the plain language of the statute in search of a possibly contrary congressional intent is a, quote, step to be taken cautionally, end [p. 18] quote, even under the best of circumstances. Again quotations, or citations, rather.

Finally, we respectfully, your Honor, urge the Court to consider the congressional history of RICO and the Supreme Court's liberal analysis of it.

One of the threats to society that is posed by organized crime in securities matters was specifically considered and was large scale market manipulations when RICO was passed; thus, this is the kind of case that congress had in mind when adopting the language: Fraud in the sale of securities; and contrary to what the Zepkin court said, the United States Supreme Court stated in SEDEMA that, quote, RICO was an aggressive initiative to supplement, and I underline the word supplement, old remedies and develop new methods for fighting crime. That's 473 U.S. 498

Further, it said, quote, that all of RICO's provisions should be read and observed on all the legislative statements about the novel, and I underline novel, remedies at attacking crime on all fronts.

What fraud in the sale of securities here? They include, but they certainly are not limited to, Holmes massive campaign of misrepresentations regarding the CD 3,000 which provided the bankroll for the Bunnington and other manipulations.

[p. 19] Outsider – insiders like Holmes, Vigman and Diamond selling Aero Systems stock at inflated prices, all sales in furtherance of their scheme and all sales profiting them individually.

Insider trading by Holmes, Vigman, Diamond, Blumenthal and others especially the sale of Aero Systems stock by Vigman and the culmination of the 1976 plot of selling those securities to Mr. Lugo so that he could continue to maintain the Bunnington manipulations and the Aerosonics manipulations; Holmes' purchases and sales of Bunnington stock to falsely reflect market activity in Bunnington; preferential treatment to Mr. Holmes by Mr. Lugo. Mr. Holmes' parking. It was a sale and recorded as a sale and shown by Mr. Holmes on his own documents as a sale conveying legal title to hide beneficial title.

Holmes sale in 19 – in November of 1980 of inflated Aero Systems stock to buy Bunnington stock, a classic 1962a violation.

Holmes publication of false Bunnington press releases to aid in the Bunnington manipulation.

Holmes publication of false information concerning Aerosonics, the so-called collision avoidance device.

Holmes participation in the stock manipulation by creating a sham dealership for Cascade Data. It could [p. 20] go on.

In sum, the Zepkin court formulated another restrictive impediment to RICO in a case which was not a case in which RICO should have been argued at all. It did so in light of the clear admonition of the Supreme Court in SEDEMA that RICO is to be read broadly and used broadly to provide new remedies and that is I respectfully urge, Your Honor, as far as standing is concerned the court has every right to follow the dictates in the Warner case and the concepts set forth in Zepkin.

That applies to standing and Mr. Samet briefly addressed the causation issue and you want me to address that.

It's slightly different.

THE COURT: You mean causation in the RICO context?

MR. TAYLOR: Yes. In the RICO context, this business about lost transaction and that kind of thing.

THE COURT: Go ahead.

MR. TAYLOR: Holmes' causation argument rests on the legal argument: Plaintiff's can't show causation. In other words, the legal link between plaintiff's damages and Holmes acts, whether you call it loss causation or flow or indirect injury or intervening cause or too remote, whatever label you put on it, it boils down to whether or

[p. 21] not there is a sufficient nexus between those acts and the damage caused to us.

Holmes seems to concede, as well he should, that the Aero Systems manipulation by itself is a question of fact for the jury.

And this causation argument seems to be hinged on two factual contingents; first, as shown on page 12 of his opening brief, Holmes claims that if a manipulation of Aero Systems stock had caused the brokerage firms to fail, one would expect to see large quantities of Aero Systems stock in the inventory and that the Aero Systems stock price would fall precipitously.

Rather, they say: This is based on a hearsay exhibit with no foundation, an ASD report. They say that Bunnington stock was held in large quantities in the inventories and its stock dropped precipitously on the collapse of the brokerage houses.

In short, Mr. Holmes is saying: I didn't cause it. The Bunnington manipulation caused it. It's an important fact to remember in their argument, Your Honor.

Second, Holmes states on page 45 of his opening brief that it was the decision of Lugo and the Sebag brokers that were the direct and intervening cause of the collapse, end quote.

[p. 22] Holmes implies that plaintiffs rely solely on Mr. Holmes' manipulation at Aero Systems stock to connect him to the collapse and this is simply not the case.

For the sake of argument, let's accept the fact that Holmes' arguments are correct; in other words, Bunnington caused the collapse and Lugo's independent acts of accumulating inventory caused the collapse.

If you accept those two arguments, Your Honor, Mr. Holmes is condemned himself to a trial by jury. Holmes' culpability for the loss can be adjudged by a jury without even mentioning the Aero Systems manipulation.

First, there is a mountain of evidence to go to the jury about Holmes' conspiracy with Mr. Vigman and Mr. Lugo; and if the Court believes that it's a jury question regarding whether or not Lugo and/or Vigman manipulated Bunnington stock or whether or not as Mr. Holmes' asserts Lugo was the one that bought up all the Bunnington stock, then Holmes, as a conspirator or aider and abettor or whatever you want to call him or both, is just as responsible for those acts as Mr. Lugo and/or Mr. Vigman.

If the decisions of Lugo are indeed the direct cause of our damages, Holmes says on page 45 of his opening brief, then Mr. Holmes is Mr. Lugo's baggage.

Let's look at the flow of the cause from the Bunnington stock manipulation which Holmes, at least in his [p. 23] motion concedes, was the cause of the collapse and let's put Mr. Holmes in that flow.

The history of the Holmes' relationship with the principals of Bunnington, the felon Vigman and under indictment Mr. Joe Lugo, go back to 1967 as set forth in the statement of facts.

The first time that we can locate that Mr. Holmes owned stock in Bunnington was the same year that it was incorporated in 1969, 20,000 shares.

In September of 1979, Mr. Holmes bought a Bunnington convertible debenture for $100,000, convertible into 40,000 shares of Bunnington stock.

Now, Your Honor, I am going through this whole thing without mentioning the Aero Systems manipulation.

Now, this debenture is an important factor because it should be for a jury to decide whether or not this served as a motive. This debenture served as motive for Mr. Holmes to do what he did regarding Bunnington.

The stock he obtained there was convertible upon the conversion payable at $2.50 a share would have been worth 10 to $12 in September of 1981, less than two months after the collapse had Mr. Holmes and Mr. Lugo and Mr. Vigman not caused the collapse of First State and Sebag. But this, Your Honor, again should be for a jury to decide whether indeed it's a motive.

[p. 24] At or about the time Mr. Holmes purchased this debenture, he started purchasing blocks of Bunnington stock, and I have a copy of an exhibit I'd like to show you. It's in the record prepared by Mr. Holmes himself.

Counsel will know what it is since I had to fight to get it from him. If I could hand that up.

I have highlighted on all copies. It's Exhibit 3863 for identification. This is produced during Mr. Holmes' deposition, Your Honor.

If you will note on the second page, I have highlighted transactions which show a very interesting pattern. I don't hesitate using that word in this case because it fits right in the pattern.

You will note there are successive purchases, which are blue lined by Mr. Holmes, through First State Securities of Bunnington stock.

Six, I believe, purchases of 5,000 shares each, one purchase of 2,500 and they are spaced fairly regularly. Then after each purchase, there are a series of sales through other brokers, small sales: A thousand here, 750, 500, 600, 200, definite pattern.

Our expert has concluded, and it's for a jury to decide, whether or not indeed this was Mr. Holmes direct participation in a manipulation.

Your Honor, during this period of time, Mr. [p. 25] Holmes and Mr. Lugo dominated the market in Bunnington. That's Mr. Holmes and Mr. Lugo dominated the market of Bunnington.

On these days, there were some days when his purchases and his sales were 90 percent of the volume of that stock.

The pattern itself suggests to me, a layman, not a stockbroker, that Mr. Homes is buying blocks and selling out to create a market and indeed our expert has said so. But in any event, regardless of what I think and regardless of what our expert thinks, I know that Mr. Samet thinks differently; but, really, it's for a jury to decide

whether Mr. Homes was directly involved in the manipulation of Bunnington stock, the very stock, the value of which according to Mr. Holmes caused the collapse.

This is further interesting, Your Honor, this one exhibit, because as you can see, there is a red line across one transaction. That transaction, Your Honor, was a parking transaction. It's the only instance out of all these trades, all of them, where Mr. Holmes sold stock, so-called sold in quotes, through Joe Lugo's firm. Why is that?

Well, the jury will decide it, but we'll urge the jury to the view that it was because it was a part that it was the only so-called sale through Joe Lugo. It [p. 26] disrupts the pattern.

And you will also note one other thing about this exhibit, Your Honor, the graphic growth of price of the stock between the 30 entry – excuse me – August 17, 1979, 350 through 5/5/81, 11.37, down to 5.29; the day of the park, $12. Quite a growth.

Getting to the park, Your Honor, the parking transaction, Mr. Holmes cries that it was not park. Again, this is a jury question to decide. The plaintiff's expert says that it was. And it's interesting to note that the expert says and the evidence shows that Mr. Holmes, because of the nature of the transaction, knew that it was a park.

Again, he didn't think about his motive to back this debenture. He sees Bunnington stock needs help. Joe Lugo comes to him, asked him for the first time in history of the firm, "I have got to have a sales transaction. I have

got to have you buy stock from me to get it out of my inventory."

It shows intent, Your Honor. It shows an absolute direct involvement by Mr. Holmes in maintaining price of that stock, of protecting the price of that stock, of knowing that Mr. Lugo is in trouble and needs to buy this stock and have it inventoried; at least he needs to keep the price up. It shows a direct, knowing intent and direct implication of Mr. Holmes.

The expert, our expert says that Holmes and Lugo jointly dominated and controlled the Bunnington market.

But I think the Court should descide [sic] whether or not it's a park and whether or not Mr. Holmes intentionally participated in the Bunnington manipulation.

Again, this is all seen in the context. It should be seen in the context of Holmes' motives. He had two motives, Your Honor, that I think the jury should decide: One is to protect his friend Mr. Vigman who was a major shareholder in Bunnington and to protect his friend Mr. Diamond who was a major shareholder in Bunnington.

Two, he wanted to protect the inflated price of Bunnington because he wanted to protect his investment in that letter, that convertible debenture rather.

He only needed to do it until September when, through the inflated price, through manipulation, he could sell his shares under rule 144. He missed it by two months.

Also, Your Honor, this is the only place in the Bunnington manipulation where I have to mention the Aero Systems manipulation, but Mr. Holmes expedited Mr.

Vigman's 144 sale so that Mr. Vigman could get money into Lugo to perpetuate the Bunnington and Aerosonic acquisition.

Now, in addition, Holmes promoted Bunnington [p. 28] stock through Moore and Schley. He introduced Moore and Schley to Bunnington principals who sold their Bunnington stock through Moore and Schley.

Holmes sent Moore and Schley a Bunnington press release with false and misleading statements in it.

Holmes discussed with people from Moore and Schley the availability of financing for Bunnington. Holmes profitted [sic] from insider information with respect to Bunnington; and saying all this, I am avoiding all of the prior relationships between Mr. Holmes and Mr. Vigman and Mr. Lugo which are all set forth in the statement of facts.

Now, if it isn't a jury question as to whether or not Holmes directly participated and, in fact, materially assisted in the Bunnington manipulation, isnt' a question of fact.

When Mr. Holmes' own argument says that Bunnington caused the collapse of First State and Sebag, that is the direct flow; and in that scenario, he's no assistance from the obvious Aero Systems manipulation of Holmes, Vigman and Lugo. It is on its own and by Holmes own argument a scenario which must let a jury decide whether or not Holmes is directly responsible for the collapse.

Now, unless Holmes tries to argue that Lugo did it all, is it not for the jury to consider the same [p. 29]

factors: Motive, trading patterns, domination of the Bunnington market by Holmes and Lugo, preferential treatment given Holmes by Lugo, Holmes' knowledge of the participation in the parking transaction with Lugo, the prior relationship between Holmes and his friend Joey Lugo and the fact that Lugo got insider information concerning Aero Systems from Holmes, and shouldn't the jury be able to decide from those and other facts whether or not Holmes was indeed with Lugo and is indeed responsible for Lugo's acts of accumulating Bunnington stock and falsifying documents to try to help the Bunnington manipulation and keep it going and protect Mr. Holmes' debenture.

Thus, by his own arguments, Holmes in furtherance of the Bunnington manipulations has put himself directly into the collapse of those brokerage houses and a jury should decide first whether or not he did it.

I believe the jury would decide that; but, secondly, Mr. Holmes' liability for them.

Now, with respect to the Aero Systems manipulation, Your Honor, that's the second portion I wanted to address.

I don't believe that even Mr. Holmes' counsel would say it's not a jury question to say whether or not there was a manipulation, or whether or not Mr. Holmes participated in it or whether or not Mr. Lugo and Mr. [p. 30] Vigman participated in that.

Their argument is remoteness. I contend, Your Honor, that even the Aero Systems manipulation itself is not too remote. In the first defendant, Holmes, in his papers, has

attempted to dissect and insulate various elements of his fraud.

To allow this and to hold that various isolated incidents cannot go to a jury moors the lines of the cases such as Kaplan and Competitive Associates which we cited in our papers which hold that so-called loss causation, which is a term, I think, an artful term which really has no meaning beyond causation itself, cannot be judged on separate misrepresentations but on the effect of the entire scheme or artifice to defraud.

Indeed, it's this concept which most fully applies SEDEMA's caution that RICO must be read and applied liberally.

It's the entire scheme that hurt the plaintiffs, not a single representation by Holmes or act by Vigman or act by Lugo.

THE COURT: You are still addressing the RICO causation?

MR. TAYLOR: I am still addressing the RICO cause of action and the first part of my presentation which goes solely to holding Mr. Holmes in on the Bunnington [p. 31] manipulation alone, the one he says caused the collapse. Okay. Let's accept that.

Then the jury should decide whether or not he's part of it and I think we have more than sufficient facts to go to the jury on that issue.

THE COURT: What about causation in the securities act?

MR. TAYLOR: Causation in the securities?

THE COURT: Yes.

MR. TAYLOR: The causation – the causation in the securities area is handled by fraud in the sale of securities, Your Honor. It is much broader than your traditional 10b-5 causation scheme.

As I pointed out, in our case of Warner, the Warner case, let me point out that Holmes is saying "Hey, you can't hold me liable for the Aero Systems manipulation because, gee whiz, the Aero Systems manipulation didn't cause the collapse. It was too remote." That's what he says.

First he's saying that the Bunnington manipulation did it and I say, "Okay. Let's accept that." And now I am showing how the Aero Systems manipulation was really part of a scheme and as such is not remote at all because of a case which I will cite to you.

It's the entire scheme which hurt the [p.32] plaintiffs, not by a single representation by either Holmes or Lugo.

As we can see in the Bunnington manipulation, it was not just false press releases and SEC filings, but Lugo and Holmes' domination of the market, Holmes' pattern of buying and selling and his parking is attributed to him.

They cannot be isolated as the Aero Systems manipulation should not be isolated to the entire scheme and to effectuate what RICO is supposed to do.

If ever, Your Honor, there was case to apply RICO and to let the case go to a jury, this case is it.

Let me show you how – and it's our argument that because of this, as shown in the causation brief, the Aero Systems manipulation – can you put those cards up, please.

I want to illustrate just graphically the Aero Systems price rise in connection with the statements made in the press and on a time line together with the sales made by the principals.

This document duplicates what is the – it's nothing new – duplicates what is attached to the expert's declaration, Your Honor. So it's not a new exhibit. The defendants have seen it. The only thing that's different is that it's colored red to show the activity.

The stock price on the left and the date at the [p. 33] bottom as the exhibit and the dates of various publications of the articles which we contend were misrepresentations together with the amounts sold by all of the principals, or some of the principals: Mr. Vigman, Mr. Holmes, Mr. Spire who is Mr. Vigman's son-in-law, Mr. Blumenthal.

You can see the concentration in 1981 on the right. See how it starts going up and keeps going up and it's maintained? It's rather graphic. It's not only graphic, but our expert says that it's absolute evidence of the manipulation.

Now, it's this manipulation that defendant says causes no damage.

Your Honor, we are entitled to prove all elements of a scheme and this is a vital element of that scheme.

The scheme was conceived in 1976 when Vigman and Diamond got valuable Aero Systems stock for worthless DCS stock, and I am sure at that time that the exact nature of how the stock would be sold or what gimmick would be gotten to sell it was not apparent, but there was no matter because Vigman had to wait and Mr. Holmes had to – sorry – vigman [sic] had to wait at least two years under rule 144 before he could sell his stock anyway.

Well, when the CD 3,000 thing came along, it was just the right thing for the conspirators. They [p. 34] accused me of using the word gimmick in connection with it in the brief, but I didn't choose the appellation. That was chosen by an ex-officer of the Aero Systems that called it a gimmick.

Now, Holmes profit early is shown on the chart under the scheme. Vigman profitted [sic] along the way and the manipulation of Aero Systems continued into the early spring of 1981, into the summer.

Now, it's clear from the facts and according to our expert, it's indeed a fact that Vigman, who was assisted by Holmes who expedited Mr. Vigman's release of the Aero Systems shares under rule 144 became Lugo's bankroll to continue the manipulation of Bunnington and Aerosonics which benefitted [sic] both Vigman and Holmes' interest in keeping the Bunnington price stock up particularly.

Now, Holmes denies this but it's the province of the jury to decide whether or not the Aero Systems manipulation was a device used by the conspirators not only to

line their own pockets but to keep the price of Bunnington going up or stabilizing, the very Bunnington manipulation which Mr. Holmes contends was the reason for the collapse.

Thus, the issue is not as defendant would, Defendant Holmes, would have the Court believe. It's not [p. 35] whether or not there is a loss causation or an intervening cause or some other purported legal impediment attached to the Aero Systems manipulation alone, but rather was the Aero Systems manipulation part of a scheme, part of a scheme not only to manipulate Aero Systems but part of the very scheme that they contend caused the damage of the Bunnington manipulation, and it was. Our expert says that it was.

And you may not believe it and Ms. Keir may not believe it and the audience may not believe it and Mr. Samet may not believe it, but a jury might and that's why it's a jury question.

Now, they cite certain cases. They are inapplicable.

First, I'd like to cite to the Court a case that I found on Saturday called Bastian versus Petron Resources Corporation. It's 681 F. Supp. 530. I am sorry I didn't cite it in our brief. I simply didn't find it. Northern District Illinois, 1988 at page 537.

The Court found no pattern but regarding loss causation, it says, and I'd like to quote: Defendants have moved to dismiss on three grounds. First, against the insufficiency of 10b and the 1780 claims means that the defendants have failed to sufficiently plead in predicate acts of racketeering activity; and, third, the third ground

[p. 36] was they alleged a RICO violation and they lack standing because they don't allege how they were injured by it.

The Court then says: The first and third elements, that's the standing and the third element, indicates that the defendants misconstrue the interaction of the securities laws and RICO claims predicated on them.

As defendants themselves argue, plaintiffs fail to state a claim under counts one and two not because defendants have not violated the securities laws, but rather because courts in implying private rights of action under these laws have imposed an additional, quote, loss causation requirement end quote.

Then it cites Newman saying, "It is only because the judiciary has created a private cause of action for damages under 10b, the contours of which are not described in the statute, that standing in such cases has become a pivotal issue," unquote.

Now, the Court goes on to say after quoting Newman, "This judicially imposed limitation on such right of action simply does not apply to the statutorily created RICO claims.

THE COURT: I thought we were switching over to the securities?

MR. TAYLOR: That's what this is. This is under RICO. We are not switching back to the security [p. 37] action.

THE COURT: I thought we were going to go over into the securities?

MR. TAYLOR: Oh, no.

THE COURT: I'm not interested in hearing anyting [sic] more about RICO.

I asked you to talk about the standing under the Securities Act.

MR. TAYLOR: No, what Mr. Samet was saying was, "Gee, since they don't have any standing –

THE COURT: I know what he was saying. I am asking you now to address the other parts of the tentative ruling. I thought I did that about five minutes ago.

MR. TAYLOR: Oh, no. I am done if that's the case. I am only addressing RICO and saying that the ruling is correct.

THE COURT: You are conceding that there is no standing under the Securities Act?

MR. TAYLOR: I am conceding that – I can't concede that.

THE COURT: Well, I said, you are not interested in arguing further?

MR. TAYLOR: All I am saying is that as far as the argument that Mr. Samet made, that you should apply the same standard –

[p. 38] MR. GRAHAM: Your Honor, I am going to address the elements.

THE COURT: All right. Take your turn.

MR. TAYLOR: All right. Thank you.

THE COURT: Just a minute. Before we do, I want to get to this very short, I hope – I have a criminal matter, all right, because I think we'll be here a few minutes longer on this.

I am going to recess this SIPC versus Vigman 10 or 15 minutes or so. All right.

MR. SAMET: May we leave our papers here?

THE COURT: Yes, you may.

(Brief recess had).

THE COURT: We were about to hear from Mr. Graham on what?

MR. GRAHAM: That's correct, your Honor. As to the claims brought by the trustees under section 10b on the issue of causation.

THE COURT: All right.

MR. GRAHAM: Your Honor –

THE COURT: So you are not speaking to the standing issue?

MR. GRAHAM: I am not speaking to the standing issue.

THE COURT: I said issue. I meant the standing [p. 39] motion.

MR. GRHAM [sic]: Let's clarify something, and perhaps there was some confusion. Is it my understanding that as to the standing issue, the court's order or tentative ruling is that the 10b-5 claim of SIPC would be dismissed; is that correct?

THE COURT: That's the only motion that's made.

MR. GRAHAM: I am going to address the 10b claims of the trustees to which a motion for summary judgment has been made based upon causation is that the court's tentative ruling –

THE COURT: Not only against them, but also against SIPC.

MR. GRAHAM: Plus against SIPC, but let me take the trustees.

Is it the tentative ruling of the court that the trustees claim has been dismissed for –

THE COURT: Not has been, but should be.

MR. GRAHAM: – should be dismissed for lack of causation?

THE COURT: Yes.

MR. GRAHAM: Your Honor, let me point out a few things to which Mr. Holmes' concedes. He concedes that his client, Robert Holmes, participated in a manipulation of Aero Systems stock. He also concedes for the purposes of [p. 40] the motion that Bunnington Corporation was among the securities, as well as Aerosonic, that caused the demise of the brokerage firms, Sebag and First State.

There has been ample evidence submitted showing a group of people of Mr. Holmes, Mr. Vigman, Mr. Lugo, Mr. Garrity, working together in a scheme to manipulate these series of what has become known as the target securities, throughout the period of time, at least through 1980 and 1981.

In regards to the court's tentative ruling, the trustees would like to understand the court's problem with the attenuation between the conduct to which Mr. Holmes admits to and the loss.

As we see it, the attenuation is resolved because of the fraudulent scheme that has been set forth clearly in the evidence in which – a scheme to which Mr. Holmes concedes, although he said Mr. Lugo and Mr. Garrity weren't part of it. I mean, that's an issue of fact, so I am a little confused there, so if the Court has a specific inquiry regarding the trustees' claim under 10b, I would invite – I invite that inquiry.

THE COURT: Well, let me do this. You think your position is different from SIPC on causation?

MR. GRAHAM: On the causation, there is some distinction, yes.

[p. 41] THE COURT: Tell me what you think the difference is?

MR. GRAHAM: The distinction between SIPC and the trustees is that the trustees held in their inventory, in their inventory, large amounts of Bunnington stock, large amounts of Aerosonic's stock. It's the trustees position that because of the fraudulent scheme, that Bunnington and Aerosonic stock ended up in their inventories.

We submit that the evidence showing the scheme involving Mr. Holmes, Vigman, Lugo, Garrity, over a long period of time manipulated these series of stocks.

It's our contention that this is somewhat like musical chairs. If the music had stopped, so to speak, in January

of 1981 instead of July 1981, the picture would have been different.

The evidence submitted shows that at that time there were excessive inventories of Aero Systems stock and had the music stopped in January of 1981, we would be sitting here arguing about one of the other parties seeking a motion who is a participant in this scheme, a motion for summary judgment.

The point is: All of these securities were manipulated by this group of individuals and it just so happens that the Aero Systems manipulation in essence came [p. 42] to an end. The main participants had cashed out their chips and were then using the proceeds to keep the other stocks in a manipulated condition, keep the manipulation going.

As pointed out very strongly and very clearly by Mr. Taylor, there was clear motive by Mr. Holmes to keep that Bunnington stock going, a motive that caused him to park stock, caused him to promote Bunnington actively. Those are all parts of this fraudulent scheme and the test under section 10b for loss causation where a scheme is alleged is that it's the nexus between all the interacting elements of the scheme and the economic loss.

And that, I think, is what has been lost in all the paper that has been filed is the test of: All the participants of the scheme, their interacting elements, their various conduct taken as a whole and the economic loss.

THE COURT: What is, for instance, the loss to the trustees from the parking transaction. All that meant was, it seems to me in the end, the life of, we'll say, FFSC was extended a little while longer.

What's the loss?

MR. GRAHAM: The loss, one, for FFSC extended the life and brought down Sebag because the evidence shows of the large purchases taken into Sebag during that period [p. 43] of time from the end of May through July.

Now, the impact at First States is significant by the larger economic loss that's been suffered from the end of May to when the firm went out of business in July; in an area-hood of half a million dollars, did the loss increase.

Now, there is much made in the motions about the net capital deficiency as Mr. Holmes claims that the net cap deficiency was not caused by Mr. Holmes but the test is not the net capital deficiency issue. It's the economic loss: Did the conduct of the scheme cause the economic loss?

The participants in this scheme all share that responsibility. Mr. Holmes specifically shares that responsibility in relationship to FFSC through the extension of the life of FFSC and causing an economic loss of half a million dollars more than had the business ceased to exist in May of 1981..

THE COURT: All right. Anything else?

MR. GRAHAM: In conclusion, Your Honor, there is the attenuation problem.

When one examines the fraudulent scheme concept and the evidence which has been presented, there is ample evidence for this court to conclude that this issue should go to the jury.

[p. 44] MR. BONNER: Your Honor, Joel Bonner for SIPC. I can address, if you would like, the standing issue as it relates to the motion brought solely in SIPC.

THE COURT: Under the Securities Act?

MR. BONNER: That's right.

In your tentative ruling, Your Honor stated that SIPC, in your opinion, should come forward with evidence of a wrongful use of the stock that was pledged.

THE COURT: Well, what I mean to say is: There is no evidence either way whether or not the pledge was authorized; right?

MR. BONNER: Yes, there is evidence of that, Your Honor.

THE COURT: What is the evidence?

MR. BONNER: There is a declaration filed by Mr. Stranahan who was the SIPC representative in charge of the liquidation of First State.

THE COURT: But he doesn't know whether it was authorized or not.

MR. BONNER: He doesn't know whether the pledges were authorized or not?

THE COURT: Yes.

MR. BONNER: I believe he does, Your Honor. They were able to determine which of the stocks were fully paid for customer stocks and which were not.

THE COURT: All right. So what?

MR. BONNER: The fully paid for customer stocks were stocks that could not be pledged under the law under the SIPC regulations.

THE COURT: I don't think that's accurate. That's the whole point. You are just relying on what you perceive to be a legal presumption, and I don't agree with that. I don't think it's quite black and white.

I don't believe there is an absolute prohibition; and even if there is a prohibition, suppose the customer authorized it anyway? There is no proof that the customer didn't authorize it, is there?

MR. BONNER: Your Honor, I think that the proof is two-fold: One is that it's illegal and –

THE COURT: That's not proof. That's statement of a proposition of law.

MR. BONNER: Okay. Secondly –

THE COURT: And a point with which I disagree.

Go ahead.

MR. BONNER: Okay. Let me point out that assuming that it's illegal and let me cite to you 17 CFR 240.8c-1 and 15c-2-1.

Assuming that it would be illegal for a broker to pledge fully paid for customer stock, why would a customer in his right mind authorize the broker to pledge [p. 46] that stock, his own stock?

THE COURT: Was there some secret promise for a higher return? I have no idea and neither do you.

MR. BONNER: Your Honor, at the very least, the defendants have not come forward with evidence that any of this stock –

THE COURT: It's not their burden. It's your burden under Celotex to prove every element of your claim, that's one of the elements that you have standing and the Ninth Circuit said so in so many words. You took the appeal from the motion to dismiss and the Ninth Circuit says, "Well, you haven't shown us any way that you can state a claim, but you claim you can, so we'll give you a shot." And you have had your shot and you haven't shown it.

I mean, your case is based on speculation. There is no proof at all that the customers didn't authorize it. There is not one shred of evidence, admissible evidence, to support that theory.

I agree it's a plausible theory.

MR. BONNER: And, in effect, that's what we are saying, that it is implausible to think that of the thousands of shares –

THE COURT: But you can't go to the jury with that.

MR. BONNER: – of customer paid stock, that [p. 47] all of those shares were authorized by customer to be illegally pledged.

THE COURT: But you can't go to the jury on the basis of plausible evidence. You have to have some proof.

I think if that's what the evidence consisted of trial, I would grant a directed verdict because there is no evidence to support your claim.

MR. BONNER: I don't think I have anything further.

THE COURT: All right.

MR. BONNER: Your Honor, if I may be heard on just one point that I failed to address when you asked was there anything more.

I would like to emphasize, again as has been made a number of times, going all the way back to the first motions made, that the trustees stand before the Court with a 10b claim in the same shoes as any other purchaser or sellers of securities.

I wanted to reemphasize that we are not just a member of the class and we ended up owning stock at the end and we are damaged by that.

And in that situation, we are not any different than anyone else who purchases securities.

THE COURT: All right.

Mr. Samet, you want to be heard further?

[p. 48] MR. SAMET: Just really very briefly, Your Honor.

Much time has been taken up and I will be less than two minutes, I believe.

First, on the question of whether the trustee is or isn't like SIPC, I think they are in the identical position. The trustee said the only difference is that the trustee held Bunnington stock in its inventory and somehow that makes the trustee a purchaser.

I don't see that as a difference. The trustee didn't purchase the Bunnington stock. They simply held it as trustee and then administered back to the various customers of brokerage firms; so I see the trustee and SIPC in the same shoes. I see no difference between them with regard to the causation issue.

Mr. Graham mentioned that he thinks the parking transaction extended the life of First State. The issue is not "did the parking transaction extend the life of First State"; if the life of First State went on, it could have gotten better. It could have gotten worse.

The point is that whatever happened to First State after the parking transaction and even through the parking transaction wasn't caused by Holmes. It was caused by Lugo and people at First State that did whatever they did.

[p. 49] I wanted to briefly respond to the RICO points. I think the controlling case there is the National Enterprise case that was cited in all the papers which says if effect that an indirect victim cannot sue when they have other remedies, and I think what we have here is SIPC and the trustees are indirect victims of any RICO damage, if there was RICO damage.

You have got a class here and the class is the real party in interest and SIPC and the trustees are almost poaching on their claims, if you will. The class should assert those claims themselves.

With regard to whether or not one needs 10b-5 standing to proceed under RICO, it seems to me that the better view, and I understand the circuits are in disagreement

on this, but it seems to me that since the idea of RICO is that there has to be a real egregious underlying claim before the extreme remedies of RICO come into effect, it seems to me that if a person or an entity doesn't have the standing under 10b-5, they shouldn't be given the greater opportunity to pursue something under RICO if they don't have the underlying claim in the first place.

If there is no standing under 10b-5, the argument is more compelling that there should be no standing under RICO.

[p. 50] That's all I have to say. Thank you.

THE COURT: Mr. Samet, you do agree that the cases differ on it? In other words, there are cases on both sides of that?

MR. SAMET: Yes, I do know the circuits are split on that.

MR. GRAHAM: Your Honor, just one response to Mr. Holmes' counsel remarks.

I think it should be clear that the trustees stepped into the shoes of the two brokerage firms. The trustees stand with 10b claims based upon the fact that they were – that the firms of First State and Sebag were purchaser and seller of securities; not the fact that the trustees, when they took possession of the assets of the firms merely administered the stock that was presented.

MR. SAMET: If I may, Your Honor. That is a different claim than I thought the trustees were pursuing. I thought the trustees were pursuing a claim for the entire estate. If they are pursuing a claim now that's a purchase of only a limited share of inventory of Bunnington or

Aerosonics, that's a different claim than was heretofore asserted.

THE COURT: Can you respond to that? Which claim are you going –

MR. GRAHAM: Yes, Your Honor.

[p. 51] I believe we go back all the way to the motions to dismiss. The basis of the court's ruling in that earlier, almost four years ago, was that the trustees stepped in the shoes of the companies, the two brokerage firms and on that basis were purchasers and sellers of securities. That is what, one, a trustee acquires when he takes over a brokerage firm, all the claims that the trustee – that the company could have brought, the trustee can bring on behalf of the company once it's in liquidation.

THE COURT: If you stepped into the shoes of First State; right?

MR. GRAHAM: That's correct.

THE COURT: I never thought of this now: There is some showing we'll say that First State was in pari delicto; right?

MR. GRAHAM: There is no showing that First State is in pari delicto. There may be an issue, and probably would be an issue raised by the defendants that Mr. Lugo might have been in pari delicto, if by his conduct, but that does not necessarily go to the corporation.

THE COURT: You mean he was acting –

MR. GRAHAM: That is an issue of fact that has to be determined.

[p. 52] THE COURT: He wasn't acting on behalf of the corporation?

MR. GRAHAM: That's correct. If he's participating in a scheme and using the corporation as the device in which to carry out his conduct and leaves the corporation holding the bag for all this Aerosonic and Bunnington stock, then I think pari delicto does not apply as to the corporation.

THE COURT: Anyway, your position is that the trustees succeeded to every claim that might have been asserted by the brokers?

MR. GRAHAM: That's correct, Your Honor. By the brokerage firms.

THE COURT: All right. All right.

Anything else, Mr. Samet?

MR. SAMET: No, Your Honor.

THE COURT: Mr. Taylor, anything else?

MR. TAYLOR: Is there anything else you want to hear in light of Mr. Samet's comments?

He said that there was supposed to be an egregious underlying claim and I submit there is one here.

THE COURT: All right. Thank you. Thank you.

I don't think I changed my mind, but I am not certain. I am going to have to think about the matter again in light of the arguments, but I have to tell you: [p. 53] My inclination is as I indicated earlier, but I am not completely set on it. So I am going to take that under

submission but I am going to rule within the next few days because we have to get on with this case.

MR. SAMET: Thank you.

THE COURT: All right. Now –

MR. TAYLOR: Excuse me. You did get the Bastian cite that I gave you? That's 681 Fed Supp., 530?

THE COURT: Yes. At 537.

MR. TAYLOR: Yes.

THE COURT: We have the motion of, I will call them the Dash defendants, to continue the pretrial. Here is my notion and then you can speak to this.

I think plaintiffs opposed the motion. I think one of the defendants at least joined.

Here's what I think I will do. I think – I frankly don't think that remaining discovery affects pretrial.

As I understand it, that's for expert witness discovery.

MR. MARCUS: That is expert witnesses and there is also concern on the part of the Dash defendants and Martin Blumenthal that in the course of discovery of one expert, he was basing an opinion of fraud on documents which had not been disclosed by the plaintiffs during [p. 54] pretrial discovery and that there would be a motion to either strike that witness's testimony or reopen discovery with respect to this new document.

THE COURT: I can't rule on that motion yet.

MR. MARCUS: I understand that, but that's still pending.

THE COURT: Here's what I intend to do: I intend to hold the pretrial conference, but the only relief that is really needed is to allow, we'll say allow additions to the expert – excuse me – to the witness list and to the exhibit list in light of the discovery that is not complete until a certain time after that and that shouldn't at all affect the preparation for pretrial to any substantial degree. Now that seems to me to be the sensible thing to do now. You can address that.

MR. MARCUS: Yes, Your Honor.

The whole concept of briefing schedules and discovery cutoff and expert schedules was to get to the point that before we had to sit down and figure out what issues were left in this case, the parties would have an opportunity to complete their discovery, complete the discovery of expert witnesses, file their motions for summary judgment and have those heard and resolved before having to sit down and go through the very complex task of preparing a pretrial order in this case.

[p. 55] You can see from just the complexity of this one motion brought by one set of the nine sets of defendants in this case, that one rule 9.4 meeting is not going to be sufficient; that the parties are, until we can complete the discovery that is outstanding, are not in a position to sit down and try to stipulate what issues are in the case, what facts are stipulated, what facts are at issue.

And to rush that process at this point I think in the overall context of the case, a 90 day continuance of the pretrial conference, given all the continuances that have been requested by the plaintiffs of this case, would not be

prejudicial. And it would lend itself to a much more orderly process.

My suggestion would be that the meeting this Wednesday be a preliminary meeting to set up schedules for exchanging of proposed stipulated facts and issues while the remaining discovery and motions be completed; and once that happens, the parties are in a much better position to sit down and make the meetings and the pretrial conference meaningful rather than have these meetings of the pretrial conference where essentially everything is left up in the air.

It's a difficult case to manage. There are a lot of parts and each part itself is very complex; and to [p. 56] rush this thing to a pretrial conference now just doesn't make any sense.

It would be a lot of wasted time on the part of the defense counsel to have each one sit through meetings with eight other defendants where they are not in a position to contribute anything before discovery is completed, before the issues are joined.

The Court has made some rulings today that at least with respect – at least made tentative rulings if they stand at least with respect to the parties that have moved may affect the issues to be tried and other defendants upon completion of discovery are waiting to make their motions as well. And to have a pretrial process with those issues outstanding would seem to be wasteful.

MR. SAMET: Your Honor, I would just like to indicate that I think the Court's course of action that you suggested would be fine. I think essentially the pretrial

schedule can go ahead the way it is with flexibility in view of the size of the case; that there be permitted additions based on discovery of additional experts, additional documents, additional witnesses; and as long as the pretrial is not fixed in concrete, it will move the case along to get most of it done.

My guess is that we could have a 90 percent pretrial in accordance with the existing schedule and do [p. 57] the additional clean up within the next few months following the pretrial.

MS. McDANIEL: Susan McDaniel for defendant Martin Blumenthal.

We join in the Dash defendants motion for continuance of the pretrial in large part because we agree with the Dash defendants that I don't think it's possible to hold a meaningful pretrial conference at this time and particularly to meet with seven or nine sets of defendants where plaintiffs at this time are trying to structure and narrow the issues.

As was noted in the Dash defendants motion, largely because of the illness of plaintiffs major expert, Mr. Seiden, all of this discovery has been pushed over; and not only the discovery, but especially the summary judgment intending to be brought not only by the Dash defendants but also by my defendant. In light of that, Your Honor, those –

THE COURT: Are you saying you have a summary judgment motion that hinges on discovery not yet done?

MS. McDANIEL: No. We were waiting to have those summary judgment motions heard until after the discovery was completed.

THE COURT: You probably waited too long. We are not going to hear these seriatim from each defendant. [p. 58] We'll go on for years and years and years.

MR. GRAHAM: Your Honor, if I could clarify something.

THE COURT: I thought I set a cutoff date for making a motion?

MR. GRAHAM: It was extended by stipulation, Your Honor. The stipulation and order on July 1st is the date of the order, and because of Mr. Seiden's illness, a stipulation was entered into and an order entered that stayed certain of the expert witnesses' depositions and also would allow a second series of summary judgment motions to be brought pursuant to a schedule set forth by the Court. That was the order that was entered.

THE COURT: What do you mean by "to be set forth?"

MR. GRAHAM: To be set by the court.

THE COURT: At what time? At the point after the completion of the discovery?

MR. GRAHAM: It was not contemplated necessarily that the depositions of the experts would be completed, but that once it got to a position where, in essence, the parties realized that they could go forward with their motion for summary judgment, that the motions could be

filed, then pursued to an organized briefing schedule as set by the Court.

[p. 59] MR. SAMET: I would agree with what Mr. Graham said with one modification. I think it was contemplated that the expert discovery would be completed.

In other words, making the motions that we can make now which are unrelated to the expert testimony and that's what we just did now. There remains expert testimony to be completed.

When that is completed, we understood the court would then set another briefing schedule; one schedule, one time for everyone to make the motions if any they want based on the completion of expert discovery.

THE COURT: All right. Go ahead.

MS. McDANIEL: So in summary, Your Honor, to go on and hold the pretrial conference and the meeting of counsel pursuant to local rule 9.4 prior to the hearing of those motions for summary judgment, which may well be dispositive, it seems to be a needless waste of time and expense on all of our behalf.

But beyond that, Your Honor, I would suggest and I think that both Mr. Taylor and Mr. Graham would agree with me that the meeting that they called for this Wednesday is in all respects a preliminary meeting and is not going to be the final and substantive 9.4 meeting that is contemplated by the rules.

In light of that, I would suggest that this [p. 60] meeting which is scheduled for this Wednesday to perhaps be and organizational meeting. I think we are going to need a lot of organization. I think we may well need a

briefing schedule in order to have different sets of defendants exchange preliminarily their statements of fact and contentions of law so that when we are finally able to meet, those meetings can be conducted in a meaningful manner and I would request that for this preliminary meeting that since we have substantial amount of trial counsel on the East Coast that those nonlocal counsel be allowed to participate in this meeting via telephone.

THE COURT: All right.

Mr. Taylor.

MR. TAYLOR: Your Honor, I'd like to keep the scheduling if we could. I agree with the young lady's assessment of the meeting on Wednesday. I don't think it's going to be a traditional 9.4 meeting. I have discussed that with Ms. Hargis and we are going to do what we can.

Because of the number of counsel and because of the number of Your Honor's issues, I would like to be a little more flexible than the rules would ordinarily allow but I would like to get on with the matter and try to hold to the schedule the best we can.

Wednesday, I would like to try to exchange witnesses, at least who we believe we are going to call. I [p. 61] have got a list of exhibits. I hope others do, too.

We can discuss who will be here for trial, what depositions we need to use, how we are going to mark the depositions, what colors we are going to use, various parties are going to use.

There is about 10; so we'll have to select a number of colors to mark the transcripts and how we are going to transmit the transcript, what transcript we are going to

use as a master. There are a number of things we can get accomplished and I'd like to keep it on schedule as much as possible.

That's my position on that issue.

THE COURT: All right. Anybody else want to be heard.

MR. GELFAND: Marty Gelfand appearing for Seymour and Marty Vigman.

I'd like the Court to consider the financial disparity nature of some of the defendants vis-a-vis SIPC and the funding they have. It's going to take some of the defendants a long, long time to review documents and depositions because as of this point, only one of the defendants has copies of everything.

The briefing is something I'd like some additional time so that after we see the documents and read the depositions, we could file meaningful documents with [p. 62] the Court, but the financial problems that many of the defendants have has certainly inhibited us in our preparation and we do need some additional time.

THE COURT: Anybody else? What's the – I am trying to find that motion. What's the date now for the pretrial conference?

MR. TAYLOR: December 5, Your Honor.

THE COURT: December 5.

MS. HARGIS: Yes, sir.

THE COURT: All right.

Mr. Marcus, how much time do you want?

MR. MARCUS: We have requested a continuance, I believe, at least 70 days from the completion of the scheduled depositions, which is sometime in mid November. I would request a continuance of about 60 days or 60 to 90 day range depending on the court's calendar for the pretrial conference, which would push it to sometime around February of 1989.

THE COURT: All right. Anybody else want to be heard?

MR. GRAHAM: One point. There has been a lot of problems as far as the scheduling of expert witness depositions and I'd like the Court to order that as to the remaining expert witness depositions both the plaintiffs and the defendants that the parties enter into a [p. 63] stipulation that become an order as to when those dates – when those depositions would take place and where. I think it might be helpful for everybody.

MR. MARCUS: I am sure that from our point, we'll try to cooperate as much as possible and I believe agreements have been reached in terms of the timing and place of expert depositions.

I don't anticipate that being a problem.

MR. GRAHAM: I'd just like to see that converted to an order so that we have a little more formality as to when these take place because it's too informal as to when they have been scheduled and taken off calendar to accomodate [sic] particular schedules and its been a nightmare for me in keeping track of all the plaintiffs'

experts, as well as we haven't gotten down to the defendants' experts yet.

MR. MARCUS: I am not sure whether Mr. Graham is asking for a specific stipulation of dates and places now or just directed that the parties cooperate and I would have no objection.

MR. GRAHAM: I was asking that the parties cooperate.

MR. MARCUS: I have no objection to that being embodied and I think it's inherent under the responsibility of counsel, under the Court rules and the Rules of Federal [p. 64] Procedure.

THE COURT: You speak about wasted time. It seems to me, you know, it's almost certain to be a waste of time to predicate a summary judgment motion on an expert witness's testimony. I just can't conceive how that couldn't be controverted. So I don't know.

People are planning to make – it sounds like they are – summary judgment motions predicted on expert testimony. I think you are –

MR. MARCUS: I think we are waiting to see what the plaintiffs' expert have to say before we draft the motion, not their own expert's testimony, but the opposing expert testimony that they were trying to get before they drafted their motions.

THE COURT: If expert testimony on either side is going to be relevant to the determination of the summary judgment motion, I just don't see how – I won't even talk about being hopeful about winning the motion or even

spending the time even making the motion. I don't know how it's going to change.

In other words, I can't see how, and I have no idea what they are, but how summary judgment motions that haven't been made yet are going to affect the course of this case.

MR. MARCUS: Your Honor, I believe it's the [p. 65] intent of the parties that all of the summary judgment motions, whether dependent on expert testimony or not, would be made after the completion of the expert testimony.

That was contemplated in the original briefing schedule and everything was delayed because of Mr. Seiden's illness. And the contemplation of the parties as indicated by the stipulation of July 1st stipulation and order was that the parties had the option of moving that back, both the deposition schedule and the scheduling to file the motion for summary judgment, and it was contemplated that once the depositions were completed, the court would establish a briefing and hearing schedule for the summary judgment motions.

I don't think it was contemplated by at least my clients, that there would be – that they would file a summary judgment now and another one later; but, rather, just one motion to be heard all at once. And it was their desire to complete the discovery of the opposition's experts before drafting their motion.

THE COURT: All right. Anybody else want to be heard?

MR. PASH: David Pash. I represent Aerosonic Corporation and Mssr. Frank and Goldman. I'd like to just add my voice in support of the motion to continue the rule 9.4 conference for the reasons indicated; and in addition [p. 66] as far as my client goes, we are still awaiting some supplemental interrogatory responses that go to the issue of what representations are allegedly fraudulent and what acts are in reliance of those representations.

Now I know we are going to get those shortly; in fact, I believe this week; but the fact remains that they are still outstanding and we still have to see what they show before we can determine what issues are going to be outstanding as to our clients and what kind of documents and exhibits are going to be relevant for our purposes.

Once again, it is just one more factor weighing in favor of some continuance in this 70 to 90 day range of the rule 9.4 conference. It's not just the expert testimony in our case. It's the other evidence as well.

MS. McDANIEL: Your Honor, if I might add one point: In defendant Blumenthal's case as well as in Mr. Pash's clients case, it's also a fact that now that this expert discovery is being conducted, suddenly new factual issues are coming to light.

It's not a matter of the defendant's – pardon me – the plaintiff's expert opinion so much as suddenly the facts upon which those opinions are based are suddenly bringing new facts to light and as we raised in our joinder papers, where defendant Blumenthal is concerned, we suddenly learned of new documents which purportedly contain [p. 67] misrepresentations which were never

identified by the plaintiffs before in spite their arguments in opposition to this motion.

I have to say those arguments are somewhat disingenuous because the previous discovery that they referred to just referred to generically to types of documents without referring specifically to documents that they claim misrepresentations were made; and then in the latter discovery responses, they purported to exhaustively identify those documents in which they claim misrepresentations were made and now we have learned through Seiden's deposition that there are more than the 44 documents they specifically identified in those earlier interrogatory responses that they are now belatedly claiming contain misrepresentations; so it's not a matter that we are waiting for expert opinions, but that there may well be other traps for the unweary in those depositions.

Thank you, Your Honor.

MR. TAYLOR: Your Honor, if I may, those are public documents, 10-Ks and 10-Qs and other documents that contained misleading statements. We certainly don't want these parties to claim prejudice because of some alleged failure to release documents at an expert's deposition.

We certainly would work with them to cure any so-called claimed prejudice even though they knew that we [p. 68] were claiming 10-Ks and 10-Qs had generically had contained false statements.

For that reason, and for the reasons I said before, Your Honor, we are happy to work with the defendants to

accommodate their schedules and their problems. There are a lot of us.

So it works two ways, but I'd really like to try to keep the schedule we have; but if we can't do it, we can't do it; but I'd like to get done what we can; and it seems to me if we hold the present schedule and look toward the pretrial conference perhaps as more of a senior status conference with a draft perhaps of a pretrial order, if we haven't been able to reach one, we can do that; but at least try to have a schedule that holds ourselves basically to the fire so we can get things done. These things tend to lead out and lead out and lead out.

THE COURT: All right.

Here's the ruling: I am going to grant the motion to this extent, and I made a note and then I lost it.

I am going to grant. I am going to continue the pretrial conference from December 5 to January 10. I will make it January 17. The reason I make it January 17 is because – excuse me. January 16. Monday, January 16, 3:00 P.M.; and the current date of December 5 has been [p. 69] converted to a status conference because I expect by that time, if they are not already filed – the clerk tells me that's a holiday, January 16.

MR. MARCUS: Martin Luther King's birthday, Your Honor.

THE COURT: I am doing this without a calendar of our 1989. Then I am going to push it back to January 10 at 3:00 P.M. Excuse me. January 9, 3:00 P.M. January 9 at 3:00 P.M. That's a Monday afternoon. Let's see.

We'll make December 5 a status conference and by that time, one, discovery should have been over for several weeks, completed, I would think. I would think they would be completed –

MR. GRAHAM: Your Honor –

THE COURT: – by mid November.

MR. GRAHAM: No. Let me explain the problem. The problem is that in scheduling the depositions of Mr. Seiden and Mr. Torkleson for Mr. Samet, because of his schedule, we have had to carry those into January and, in fact, they don't commence until early January 23rd; so it would be actually three consecutive weeks in January where there would be depositions of the expert witnesses concluding about the second week of February.

However, as I see the local rules, that there would not be an effect under the rules of carrying [p. 70] discovery of the expert witnesses beyond the date of the pretrial conference. So I just want the Court to understand what our schedule is.

THE COURT: Let me ask this question: How much of the pending discovery do you expect to be completed – maybe I should address the defendants – by, say, the end of November?

MR. MARCUS: If I can read Jeffrey Tew's declarations that we expect to complete the depositions of Messrs Foley and Hammershaw sometime in mid November.

There is the issue of reopening discovery. I heard what Mr. Taylor said and he tends to generalize: If the defendants breathe, it's a massive fraud; but the fact is

that under rule nineof [sic] Federal Rules of Civil Procedure, when a defendant is accused of fraud, they are entitled to specificity. This is the statement. Here is where it's made. This is the person who made it and this is the person that he made to it and not just a generic: Well, he made such and such false statements in such and such documents.

The fact is that in interrogatories, we asked them to specify the documents and in response to an interrogatory they supposedly specified the documents and now we discover when their expert takes the stand that there are more documents.

[p. 71] THE COURT: I don't want you to tell me your troubles. I just want to know – remember my question?

MR. MARCUS: The point is that there may be a motion to reopen discovery based on all of these new documents that all of a sudden platinfiss [sic] are now relaying [sic] on which they didn't disclose in prior discovery; so until that motion –

THE COURT: Reopen discovery generally?

MR. MARCUS: As to specific issues raised by that. Other than that, the Dash defendants would be able to complete their expert deposition testimony, I believe, by mid November based on the declaration of Jeffery Tew. I can't speak for the other defendants.

THE COURT: Mr. Samet.

MR. SAMET: I believe discovery, with respect to the Holmes' aspects of the case, probably won't be completed until February or March. The schedule that Mr. Graham

mentioned is, as he indicated; and then following that, they are entitled to depose certain of our expert; so I think discovery would be completed in March, but I would have no objection to the pretrial conference being completed before then because I agree with Your Honor. I don't think much significant summary judgment material would be coming out of that.

THE COURT: What does that mean?

[p. 72] Does that mean that you would be ready to or not – you already made your motion. The other defendants would be ready to brief their motions before the end of discovery? Summary judgment motions, I mean?

In other words, you think you can make your summary judgment motion, say, by sometime in December, if you intend to make them. I am not encouraging it.

MR. MARCUS: We so intend to make it. We do want to complete discovery of the plaintiff's experts before drafting the motions.

We don't think it's necessary for the plaintiffs to finish deposing our experts before we make the motions and I don't know what their scheduling is in that regard.

I assume that Mr. Graham is working that out with Mr. Dubin and I really don't know when they plan on taking the depositions of our experts except that it's after we complete the deposition of their experts.

MR. BONNER: We only have one.

MR. MARCUS: That's true.

THE COURT: Well, I think the only thing I can do at this time is: I am not going to make this open-ended now,

but I am going to abide by that schedule that I mentioned earlier which is to continue the pretrial conference to January 9.

[p. 73] And then we will have a status conference in December to see, you know, whether it makes sense to hold the pretrial conference on that January date, all right, or whether discovery is still going on to such an extent that we ought to continue the pretrial conference further because some people plan on making summary judgment motions which might affect the scope of the issues remaining in the case.

So with that reservation, I am going to grant Mr. Marcus's – it's your motion?

MR. MARCUS: Yes, it was.

THE COURT: Grant the motion of the Dash defendants in part; that is to say, I am going to continue the pretrial conference as I said to January 9 and we'll hold the status conference on December 5.

What time is that December 5?

THE CLERK: 1:30 P.M.

THE COURT: All right.

Anything else?

MR. MARCUS: Should I submit an order, Your Honor?

THE COURT: No.

MS. McDANIEL: Your Honor, with respect to the 9.4 meeting –

THE COURT: Excuse me. The answer is yes.

[p. 74] Yes, the 9.4 meeting?

MS. McDANIEL: – which has been called for this Wednesday, what happens with respect to that and if we continue with that date –

MR. TAYLOR: It's off.

THE COURT: I think 9.4 doesn't say it has to be exactly 40 days before the pretrial conference. You can have it anyway.

MR. MARCUS: Your Honor, if I might make a suggestion: I think Mr. Taylor should start the process. Perhaps we could be scheduling meetings or scheduling dates for exchanges of proposed stipulated facts.

I agree that it shouldn't be necessary for the trial counsel located on the East Coast to have to fly out here Wednesday.

THE COURT: I agree with Mr. Marcus that this case is probably just going to take more than one meeting where the lawyers sit down in somebody's office and they rough out a draft in an hour.

I think you are going to have several meetings and it's not going to hurt getting started on the preliminaries.

MR. TAYLOR: Then we meet on Wednesday.

THE COURT: Since you have a date set, I don't see why you can't start ironing out some of the [p. 75] preliminaries that were mentioned.

MR. MARCUS: I have no problem as long as it's understood that counse [sic] out of town can either be represented by local counsel.

THE COURT: Or be available by phone or participate by conference call. That is perfectly acceptable and I would encourage that. All right.

Anything else?

MR. TAYLOR: Your Honor, I do have one thing more: I'd like to reopen one comment that Mr. Samet made and it does concern me.

THE COURT: Is this on the motion?

MR. TAYLOR: Yes.

THE COURT: All right. Go ahead.

MR. TAYLOR: This involves the National Enterprises that counsel cite in their reply memorandum and I have not had a chance to either argue that case or put a memo in on it and it is not of this circuit but I would like to put in a short brief on that particular case if the Court considers it's important because it does not apply and it should not apply in this case and I have, Heaven knows, several reasons why it should n't.

THE COURT: No. I don't need another brief but I will bear in mind that your position doesn't apply.

MR. TAYLOR: Yes, but I have a reason for it, [p. 76] too.

THE COURT: I am sure you do.

Thank you very much, counsel.

MR. GRAHAM: Thank you, Your Honor.

MR. TAYLOR: Thank you, Your Honor.

MR. SAMET: Thank you, Your Honor.

(Proceedings adjourned).

* * *

I, XAVIER MIRELES, CSR 5001, do hereby certify that the foregoing transcript is true and correct.

/s/ Xavier Mireles 10/29/88
XAVIER MIRELES, CSR 5001 DATE

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al., Plaintiffs, v. SEYMOUR VIGMAN, et al., Defendants.	CASE NO. CV 83-4742-AWT (Tx) (Consolidated Cases)
AND CONSOLIDATED ACTIONS	ORDER FOR ENTRY OF FINAL JUDGMENT (AND STAY OF PROCEEDINGS)

CV 83-5674-AWT

CV 87-1679-AWT

FILED
DEC 22 1988

The Motion by the Securities Investor Protection Corporation for Leave to File an Interlocutory Appeal, or, in

the Alternative, for Entry of Final Judgment under Federal Rule of Civil Procedure 54(b) and for a stay of all proceedings pending appellate review came on regularly for hearing before the Honorable A. Wallace Tashima on December 19, 1988 at 9:30 a.m. After consideration of the papers filed in support of and in opposition to the Motion, and the oral argument of counsel, it is hereby

ORDERED that each of the orders granting summary judgment and the summary judgments in favor of defendant Robert G. Holmes Jr., and against plaintiffs, disposing all claims by plaintiffs against defendant Holmes, hereby is amended pursuant to F. R. Civ.P. 54(b) to include an express determination that there is no good reason for delay and an express direction for the entry of judgment.

FUTHER [sic] ORDERED that all further proceedings in this action and in the actions consolidated herewith are stayed pending appeal (if a timely notice of appeal from this final judgement in favor of defendant Holmes is filed) or until otherwise ordered by the Court, except:

1. Any activity, including motions, stipulations and orders, to negotiate and complete any settlements;
2. Motion for entry of default judgment against defendant Lugo and
3. Any discovery activity (primarily depositions) with the prior approval of the court

for good cause shown for an exception from the stay.

Dated: DEC 22 1988

/s/ AWT
A. Wallace Tashima
United States District Judge

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,	)	Case No. CV 83-4742-AWT (Tx) (Consolidated Cases)
Plaintiffs,	)	
v.	)	NOTICE OF APPEAL OF PLAINTIFF SECURITIES INVESTOR PROTECTION CORPORATION
SEYMOUR VIGMAN, et al.,	)	
Defendants.	)	
AND CONSOLIDATED ACTIONS.	)	

NOTICE IS HEREBY GIVEN that Plaintiff Securities Investor Protection Corporation ("SIPC)" hereby appeals to the United States Court of Appeals for the Ninth Circuit from the orders filed October 31, 1988 granting the motions of defendant Robert G. Holmes, Jr. for summary judgment, which orders were made final pursuant to Rule 54(b) of the Federal Rules of Civil Procedure pursuant to the Order for Entry of Final Judgment (and Stay of Proceedings) entered by the United States District Court for the Central District of California on December

22, 1988, a copy of which is attached hereto as Exhibit "A".

DATED: January 6, 1989

Stephen C. Taylor
Joseph F. Coyne, Jr.
Mark D. Larsen
Sheppard, Mullin, Richter
& Hampton

By /s/ Stephen C. Taylor
Stephen C. Taylor

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EXHIBIT "A"

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES INVESTOR, PROTECTION CORPORATION, et al., Plaintiffs, v. SEYMOUR VIGMAN, et al., Defendants. AND CONSOLIDATED ACTIONS	CASE NO. CV 83-4742-AWT (Tx) (Consolidated Cases) ORDER FOR ENTRY OF FINAL JUDGMENT (AND STAY OF PROCEEDINGS) CV 83-5674-AWT CV 87-1679-AWT FILED DEC 22 1988

The Motion by the Securities Investor Protection Corporation for Leave to File an Interlocutory Appeal, or, in the Alternative, for Entry of Final Judgment under Federal Rule of Civil Procedure 54(b) and for a stay of all proceedings pending appellate review came on regularly for hearing before the Honorable A. Walla-e Tashima on December 19, 1988 at 9:30 a.m. After consideration of the papers filed in support of and in opposition to the Motion, and the oral argument of counsel, it is hereby

ORDERED that each of the orders granting summary judgment and the summary judgments in favor of defendant Robert G. Holmes Jr., and against plaintiffs, disposing all claims by plaintiffs against defendant Holmes, hereby is amended pursuant to F. R. Civ.P. 54(b) to

include an express determination that there is no good reason for delay and an express direction for the entry of judgment.

FUTHER [sic] ORDERED that all further proceedings in this action and in the actions consolidated herewith are stayed pending appeal (if a timely notice of appeal from this final judgment in favor of defendant Holmes is filed) or until otherwise ordered by the Court, except:

1. Any activity, including motions, stipulations and orders, to negotiate and complete any settlements;

2. Motion for entry of default judgment against defendant Lugo and

3. Any discovery activity (primarily depositions) with the prior approval of the court for good cause shown for an exception from the stay.

Dated: DEC 22 1988

/s/ AWT
A. Wallace Tashima
United States District Judge

EXHIBIT "A"

Nos. 89-55094 and 89-55128

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

vs.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

On Appeal From The United States District Court For The Central District Of California Honorable A. Wallace Tashima

PLAINTIFFS-APPELLANTS' OPENING BRIEF

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CERTIFICATION REQUIRED BY CIRCUIT RULE 28-2.1

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

vs.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

The undersigned counsel of record certify that they are unaware of any parties having an interest in the outcome of this case, apart from the parties herein and the defendants below:

Seymour Vigman
Aero Systems, Inc.
Aerosonics Corporation
Creditbank, Inc.
Dash Industries, Inc.
Haberico, Inc.
Jay Dash
Phillip Dash
Isadore Diamond
Elliot I. Eiseman
Herbert J. Frank
Frankie Mae Garrity

Habers, Inc.
Habers, Inc. Defined Benefit Pension Trust
Ibebafin S.A.
Keops S.A.
Magnetic Technologies Corporation
Talingo Corporation
Tula Corporation
Martin Blumenthal
Jose Luis Calogne, aka Jose Luis Calonge Rivas
Dolores Owens Cipparone, aka Dee Cipparone
David S. Goldman
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Nettie Vigman
Lawrence West, aka Larry West

This representation is made to enable the judges of this Court to evaluate possible recusal.

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Case Nos. 89-55094 and 89-55128.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

vs.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

On Appeal From The United States District Court For The Central District Of California Honorable A. Wallace Tashima

PLAINTIFFS-APPELLANTS' OPENING BRIEF

I

PRELIMINARY STATEMENT

This appeal arises from a summary judgment for defendant Robert G. Holmes, Jr. ("Holmes") on claims for violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO") (18 U.S.C. § 1961 *et seq.*) (1982),

the Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*) (1970), common law breaches of fiduciary duty, and fraud.

Holmes independently, and with others, orchestrated and participated in a complex scheme to manipulate unlawfully six over-the-counter securities that caused the failures of two securities brokerage firms, First State Securities Corporation ("FSSC") and Joseph Sebag Incorporated ("Sebag") and the loss of brokerage customers' securities and cash.[1] As a result of these failures, the appropriate district courts, under the Securities Investor Protection Act of 1970, as amended,[2] ("SIPA") appointed Laurence A. Schroeder (as Successor to John L. Britton) and Eugene W. Bell as trustees to liquidate FSSC and Sebag (the "Trustees").

As a direct result of the acts of Holmes,[3] alone and in concert with his long-time confederates, the plaintiff

[1] Holmes and his co-defendants manipulated the six securities issued by Aero Systems, Inc., Aerosonics Corporation, Bunnington Corporation, Creditbank, Inc., Dash Industries, Inc., and Osrow Products Corporation (hereinafter the "Target Securities").

[2] 15 U.S.C. § 78aaa *et seq.*

[3] Holmes is the founder, President, Chief Executive Officer, Director and major shareholder of Aero Systems, Inc. ("Aero Systems"), an airplane used parts dealer in Miami, Florida. Clerk's Record ("C.R.") 1317, pp. 4-5. Aero Systems stock was manipulated by Holmes, (C.R. 1310, pp. 13-15) as was the stock of Bunnington Corporation ("Bunnington"). C.R. 1310, pp. 37-43. Bunnington's major shareholders were co-conspirator Vigman and Vigman's co-conspirator brother-in-law, Isadore Diamond. C.R. 1317, pp. 31 & 37.

Trustees and plaintiff Securities Investor Protection Corporation ("SIPC") have sustained damages of approximately $12.5 million.[4]

Holmes moved for summary judgment asserting a lack of causation between Holmes' conduct and injuries to SIPC and the Trustees. He also contended that SIPC lacked standing to assert claims under RICO because SIPC is not a "purchaser or seller" of securities. By its rulings entered October 31, 1988, the District Court granted Holmes' motions for summary judgment on these bases from which this appeal is taken.[5]

[4] The Appeals before this Court have been consolidated, resulting in this joint brief filed pursuant to Ninth Circuit Rule 28.4. In addition, and with leave of this Court, the Trustees present a supplemental brief.

[5] C.R. 1344, p. 2; C.R. 1343, p. 3. In addition to the causation and RICO orders, the Court entered a third order on October 26, 1988 that SIPC "lacks standing" to assert claims against Holmes under Section 10(b) and Rule 10b-5. Order of Partial Summary Judgment, C.R. 1341, p. 2. The Court's basis for summary judgment on such grounds, in light of the law of the case found in *SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986), is found in the Court's handwritten modification of Holmes' conclusions of law which states: "6. There is no evidence (SIPC having the burden under *Celotex*) that any pledge of fully-paid-for customer stock was 'unauthorized.' " C.R. 1340, p. 6.

Plaintiffs disagree with the Court's conclusion. SIPC's evidence of unauthorized pledges of securities by FSSC presented a triable issue of material fact. The Court misapplied the applicable burden of proof to SIPC's evidence. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 25[illegible] (1986); *United Steel Workers of America v. Phelps Dodge Corp.*, 865 F.2d 1539, 1542 (9th Cir.

(Continued on following page)

With respect to the RICO claims, the District Court modified Holmes' proposed findings to find expressly that there *was a genuine dispute regarding material facts* with respect to *all* of the substantive RICO issues including, *inter alia*:

> (1) Whether or not Holmes invested income in an enterprise;
>
> (2) Whether or not Holmes acquired an interest in an enterprise;
>
> (3) Whether or not Holmes conducted the affairs of an enterprise through a pattern of racketeering activity;
>
> (4) Whether or not the predicate acts alleged constitute fraud in the sale of securities, mail fraud or wire fraud; and
>
> (5) Whether or not two predicate acts occurred within ten years of each other and constitute a "pattern".[6]

(Continued from previous page)

1989). The only evidence presented to the Court on the issue of unauthorized pledges, and the only rational inferences to be drawn therefrom, reveal that FSSC improperly pledged a large volume of customer paid securities without authorization in order to receive instant loan funds from Stock Clearing Corporation of Philadelphia. C.R. 1293, pp. 4-6. As a consequence, the Court erred in granting Holmes summary judgment based on a perceived lack of evidence of unauthorized pledges of securities.

By its ruling in 1986, this Court severely limited the securities laws as they could be used by SIPC. SIPC's ability to use RICO to remedy massive fraudulent securities manipulations as occurred here must not be so limited.

[6] C.R. 1343, pp. 2-3, ¶¶ 2-4, 6 and 7.

Significantly, by the same findings, the Court found that:

> (1) There *is* a genuine issue of material fact that "Holmes conspired to violate RICO Sections 1962(a), 1962(b), or 1962(c),"[7] and:
>
> (2) There *is* a genuine issue of material fact whether or not the predicate acts caused "the injuries" of SIPC and/or the Trustees.[8]

The District Court unequivocally recognized, then, that plaintiffs presented substantial material evidence that Holmes violated *all* substantive sections of RICO, and that the violations, in fact, caused plaintiffs' damage. Yet, the Court inexplicably held in the same findings, that:

> (1) "The grant of summary judgment on 'causation' applies also to the RICO claims."[9] and;

---

[7] *Id.* ¶ 5.

[8] *Id.* ¶ 8.

[9] The Court's reference to the granting of Holmes' motion regarding a lack of causation is to the Statement of Uncontroverted Facts and Conclusions of Law regarding causation and provides, in pertinent part, as follows:

> "The proximate cause requirement under RICO (citation) is, in substance, no different than the "loss causation" requirement under the securities laws, when the predicate acts on which the RICO violation is based is securities fraud. *E.g., Sperber v. Boesky*, 849 F.2d 60 (2d Cir. 1988)."

C.R. 1342, p. 10, ¶ 23.

> (2) "SIPC does not meet the 'purchaser-seller' requirements for standing to assert RICO claims . . . predicated on violations of Section 10(b) and Rule 10b-5 of the 1934 Securities Exchange Act."[10]

The Court erred, then, when it granted summary judgment for a lack of causation because it specifically found that, as far as the RICO claims are concerned, *a triable issue of fact as to causation was presented*. Such a finding by the Court was proper in the first instance as the facts before it overwhelmingly supported the finding, as will be shown below. The Court erred by wrongfully implying the Section 10(b) and Rule 10b-5 "purchaser-seller" requirement (also part of the implied claim for relief in those statutes) into the broad, express "any offense . . . involving fraud in the sale of securities" language of RICO.[11] Further, no acceptable jurisdiction was offered for the similar implication of such limitations into the claims for relief based on mail and wire fraud under RICO.

On December 22, 1988, the District Court entered its order directing that final judgment be granted as to Holmes under Rule 54(b) of the Federal Rules of Civil Procedure. On January 6 and January 20, 1989, SIPC and the Trustees respectively timely filed their Notices of Appeal. The appeals were consolidated.

---

[10] Order Granting Summary Judgment (RICO claims), C.R. 1343, p. 3.

[11] 18 U.S.C. § 1961, *et seq*.

Plaintiffs respectfully urge this Court to reverse the District Court's summary judgment and allow plaintiffs to try their case against Holmes.[12]

II

STATEMENT OF ISSUES

(1) Did the District Court err in granting summary judgment to Holmes, when it held that plaintiffs did not present a triable issue of material fact that the unlawful conduct of Holmes alone and/or Holmes' conduct in league with his co-conspirators was the proximate cause of damage to the Trustees or SIPC under 18 U.S.C. Section 1964(c)? (Yes)

(2) Did the District Court err in granting summary judgment to Holmes, when it held that SIPC must be a "purchaser or seller" of securities to maintain an action under 18 U.S.C. Section 1964(c) for conduct consisting of (a) "any offense . . . involving fraud in the sale of securities . . . punishable under any law of the United States," (b) wire fraud or (c) mail fraud in violation of 18 U.S.C. Section 1962? (Yes)

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[12] Plaintiffs' evidence presented in opposition to Holmes' Motions of Summary Judgment is contained in the Statement of Background and Facts. C.R. 1317. The Statement of Background and Facts is too lengthy to be recited here. Plaintiffs urge the Court to review it beyond its citation in this brief to appreciate more fully Holmes' role in the fraudulent scheme and conspiracy at issue.

III

JURISDICTION AND STANDARD OF REVIEW

A. Jurisdiction.

Jurisdiction in the District Court was based upon federal questions arising under RICO, 18 U.S.C. Section 1961 through Section 1968, the Securities Exchange Act of 1934, 15 U.S.C. Section 78a through Section 78hh-1, and 28 U.S.C. Section 1331. The District Court also exercised jurisdiction over the state and common law claims alleged in the First Amended Complaint by virtue of its pendent jurisdiction. The bases for jurisdiction over SIPC's and the Trustees' appeals from the grant of summary judgments in favor of Holmes are 28 U.S.C. Section 1291 and Federal Rule of Civil Procedure 54(b), and the appeals were consolidated.

B. Standard Of Review

As recognized by the Supreme Court in *Anderson v. Liberty Lobby, Inc.*,[13] plaintiffs' burden in resisting Holmes' motions was only to present that quantum of evidence which, taken together with all favorable inferences, would be sufficient for a jury to return a verdict in plaintiffs' favor. Review of the granting of such a motion is *de novo*, and all inferences must be drawn in favor of the non-moving party.[14]

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[13] 477 U.S. 242 (1986).

[14] *Wood v. Ostrander*, 851 F.2d 1212, 1213 (9th Cir., 1988); *Leer v. Murphy*, 844 F.2d 628, 631 (9th Cir. 1988); *Medallion*

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The Supreme Court in *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, stated that the non-moving party "must do more than show that there is some metaphysical doubt as to the material facts."[15] Once the non-moving party presents evidence that is plausible and beyond "some metaphysical doubt," the District Court must consider all "justifiable" and "legitimate" inferences in favor of the non-moving party.[16] The District Court must also keep in mind that "[c]redibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from facts are jury functions, not those of a judge. . . . The evidence of the non-movant is to be believed, and all justifiable inferences are to be drawn in his favor."[17]

This Court holds that "a justifiable inference" is not "the most likely inference or the most persuasive inference."[18] Indeed, a justifiable inference is any inference that is "rational" or "reasonable."[19]

In this case, the evidence that Holmes was a principal, co-conspirator and aider and abettor in the manipulation of the prices of Bunnington and Aero Systems

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Television Enters., Inc. v. SelecTV of California, Inc., 833 F.2d 1360, 1362 (9th Cir. 1987), *cert. denied*, 109 S. Ct. 3241 (1989).

[15] 475 U.S. 574, 586 (1986).

[16] *Id.* at 587-8.

[17] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986).

[18] *United Steel Workers*, 865 F.2d at 1542.

[19] *Id.*; *See also T.W. Elec. Serv. v. Pacific Elec. Contractors*, 809 F.2d 626 (9th Cir. 1987).

stocks, and in the scheme to manipulate them, not only presents jury questions, but is overwhelming.

IV

STATEMENT OF THE CASE

A. SIPC And Its Trustees Serve Important Public Interests And Must Be Allowed To Use RICO To Assist In The Regulation Of The Securities Market.

In 1970, the same Congress that enacted RICO created SIPC as a nonprofit membership corporation established under SIPA in response to the collapse of numerous brokerage houses in order to provide greater protection for customers of registered brokers, dealers and members of national securities exchanges.[20] To bolster public investor confidence, Congress broadly analogized to the federal corporations that ensure savings and demand deposits[21] and enacted the new program, which was jointly sponsored by the securities industry and the Securities and Exchange Commission ("Commission").[22] The several purposes of that program, were:

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[20] 15 U.S.C. § 78ccc; S. Rep. No. 1218, 91st Cong., 2d Sess. 3 (1970) ("Senate Report"); H.R. Rep. No. 1613, 91st Cong. 2nd Sess. ("House Report"), reprinted in 1970 U.S. Code Cong. & Admin. News, 5254, 5254-55. Membership in SIPC is automatic upon registration as a broker or dealer with the Securities and Exchange Commission under Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ccc(a).

[21] Senate Report at 4.

[22] House Report at 28; Hearings on S. 2348, S. 3988, S. 3989 Before the Subcomm. on Securities of the Senate Comm. on

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> " . . . to protect individual investors from financial hardship; to insulate the economy from the disruption which can follow the failure of major financial institutions; and to achieve a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss."[23]

SIPA accomplished these purposes essentially by two methods. First, it enhanced the Commission's powers to establish financial responsibility rules for brokers and dealers[24] and to impose on the self-regulatory organizations[25] requirements for the financial examination of their members.[26] Second, it established SIPC, which it empowered, among other things, to commence proceedings for the liquidation of its members whose financial condition posed the threat of loss to their customers.

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Banking and Currency, 91st Cong., 2d Sess. 12 (1970). Hearings on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, H.R. 18458 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess. 330 (1970). These hearings will hereinafter be cited as "Senate Hearings" and "House Hearings."

[23] Senate Report at 4; *see also* House Report at 1.

[24] 15 U.S.C. § 78ggg(a).

[25] "Self-regulatory organizations" consist of national securities exchanges and the National Association of Securities Dealers, Inc. ("NASD").

[26] 15 U.S.C. § 78iii(f). Similarly, SIPC is given responsibility to work with the self-regulatory organizations towards the standardization of their examining procedures and the development of procedures for the early detection of approaching financial difficulty of SIPC members. 15 U.S.C. § 78iii(c).

Referring to the several aims of SIPA, the United States Supreme Court has stated: "The Act apportions responsibility for these tasks among the SEC, the securities industry self-regulatory organizations, and SIPC. . . . "[27]

Lower federal courts, too, recognize the important public function served by SIPC and its trustees: "Although not formally part of the federal government, SIPC and its trustees vindicate important public interests."[28]

The District Court's ruling, if allowed to stand, will deprive SIPC of an effective tool to correct abuses in massive fraud cases of this type, in which an ordinary individual private party simply would not have the financial staying power to bring miscreants such as Holmes to account.[29]

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[27] *SIPC v. Barbour*, 421 U.S. 412, 415-16 (1975).

[28] *In re Application of Executive Secs. Corp.*, 702 F.2d 406, 410 (2d. Cir.), *cert. denied*, 464 U.S. 818 (1983).

[29] The District Court's decision also constitutes a potential impediment to the fulfillment of the President's pledge, *infra*, note 30, as both the FSLIC and FDIC use RICO in carefully selected bank fraud litigation. *See e.g., FSLIC v. Shearson-American Express, Inc.*, 658 F. Supp. 1331 (D.P.R. 1987); *FDIC v. Hardin*, 608 F. Supp. 348 (E.D. Tenn. 1985). *See generally Combating Fraud, Abuse and Misconduct in the National's Financial Institutions: Current Federal Efforts are Inadequate*, H.R. Rep. No. 1088, 100th Cong. 2d Sess. 2-13 (1988) (Criminal misconduct by insiders is a major contributing factor in approximately one-third of all commercial bank failures and three-fourths of all thrift failures; loss estimates range from $31 to $80 billion). State insurance commissioners also are using RICO, in carefully selected litigation, to vindicate the interests of those who

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SIPC's role in the securities industry is, moreover, directly paralleled by that of similar agencies facing the white-collar-crime crisis threatening to engulf the banking and thrift industry,[30] the insurance industry[31] and the

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have been defrauded. *See e.g., Schacht v. Brown*, 711 F.2d 1343, 1356-58 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983). The District Court's judgment, too, could undermine those public-purpose projects.

[30] The President, for example, told the Nation on February 6, 1989 that "unconscionable risk-taking, fraud and outright criminality . . . [were] factors" that led to the crisis in the savings and loan industry. *New York Times*, Feb. 7, 1989, at 31, col. 1. He promised "every effort to recover assets diverted from these institutions and to place behind bars those who had caused losses through criminal behavior." *Id. Office of Comptroller of the Currency, Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks* (1988) (insider abuse significant factor in 35% of the bank failures); *New York Times*, March 11, 1989, at 17, col. 1 (FSLIC fund liabilities exceed assets by $56 billion, four times the total of a year ago). *See generally* Note, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis*, 64 Notre Dame L. Rev. 222 (1989).

[31] The insurance industry, another key component of financial markets, is primarily regulated and protected at the state level; it is facing a similar crisis, particularly in the southwest. In 1987, 234 companies were in liquidation, and 74 companies were in reorganization. *Wall Street Journal*, Nov. 8, 1988, at 12, col. 6. State guaranty funds paid out a record $909 million in 1987 – to bail out the failures. *Id.*, Feb. 17, 1989, at 1, col. 6. "Autopsies of several failed insurers across the country have turned up evidence of frauds and inadequate regulations." *Id.*

pension guaranty field.[32] As such, the District Court's narrow reading of RICO threatens more than the rights of victims of crime in the securities industry.

B. Congress Has Legislated SIPC's Role As Protector Of The Investing Public's Interest.

This appeal must be considered in the context of SIPC's functions within the securities industry.

Congress recognized the importance of SIPC's function of providing for protection of investors by requiring SIPC to establish a fund through assessments upon its members,[33] and by authorizing SIPC to borrow against

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[32] Equally disturbing, if not more so, are the similar prospects for the Pension Benefit Guaranty Corporation ("PBGC"), which insures 31 million workers and retirees in 10,000 single employee pension funds and 8.2 million workers in 2,300 multi-employer plans. In 1987, $1.6 trillion were held in pension plan assets. Yet 1987 also marked "the largest deficit . . . and the most threatening crisis . . . [in the] 13-year history" of the PBGC. *Pension Benefit Guaranty Corporation, Annual Report to the Congress Fiscal Year 1987* at 3. Here, too, "a national tragedy is in the making." 134 Cong. Rec. H. 1072 (March 22, 1988 daily ed.) (statement of Rep. Conyers). Employment and Retirement and Security Act "alone is not able effectively to protect the plans from fraud and misuse and . . . hard-earned money at substantial risk. *Id. See e.g., Thornton v. Evans*, 692 F.2d 1064, 1065 (7th Cir. 1982) (pension plan fraud) ("Evidence . . . traces a pattern which seems distressingly prevalent today: the savings of working men and women are pilfered, embezzled, parlayed, mismanaged and outright stolen by unscrupulous persons occupying positions of trust and confidence.")

[33] 15 U.S.C. § 78ddd.

the United States Treasury up to $1 billion should the SIPC fund be inadequate.[34]

SIPA contemplates that customers' claims resulting from a failed broker-dealer will be satisfied to the maximum extent possible not from the SIPC fund but from the remaining assets held by the failed broker-dealer constituting a "fund of customer property,"[35] in which all customers share ratably to the exclusion of general creditors.[36] SIPC funds supplement the fund of customer property within the limits and manner provided by SIPA.[37]

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[34] 15 U.S.C. § 78ddd(f)-(h).

[35] 15 U.S.C. § 78lll(4); 15 U.S.C. § 78fff-2(c)(1). Procedurally, a SIPC trustee marshals the assets of the failed broker-dealer and creates a "fund of customer property." The fund consists of cash and securities held by the failed broker-dealer for customers. 15 U.S.C. § 78lll(4). The fund does not include securities registered in the customer's name. 15 U.S.C. § 78lll(3)-(4). Thus, in a SIPA liquidation, a customer has any securities registered in his own name returned to him; a customer's "street-name" securities and cash in the customer's account are thrown into the common "fund of customer property."

[36] 15 U.S.C. § 78fff-2(c)(1). Before SIPA, customers only received their pro rata share of the fund (then called "single and separate fund," now called the "fund of customer property"). As for unpaid balances, customers shared with general creditors in the general estate. *See* 3 *Collier on Bankruptcy* §§ 60.73-60.76 (14th ed. 1977). Because of the usually inadequate fund, customers suffered losses. Congress moved to remedy this by setting up SIPC and its fund to make customers as whole as possible within the limits of SIPA.

[37] SIPC may advance up to $500,000 to each customer for the amount by which such customer's "net equity" exceeds his

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Regardless of the extent of assets of the failed firm, each innocent customer with a valid claim for stock or cash is assured of protection by SIPC within statutory limits.[38] Thus, a significant part of the business of SIPC is

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pro rata share of the fund of customer property, and in no event more than $100,000 for that portion of a claim that is for cash. 15 U.S.C. § 78fff-3(a)(1). "Net equity" is simply the filing date value of securities and cash the failed broker-dealer owes the customer less any amount the customer owes the broker-dealer. 15 U.S.C. § 78lll(11). For example, if the fund of customer property totaled $100,000 and the total value of the net equities of all of the customers was $1 million, the customers would share the $100,000 on a pro rata basis and SIPC would supplement the fund for each customer (over what the customer received from the fund) to the statutory limits.

[38] Customers of the two failed brokerages generally break down into two major groups – those who purchased manipulated Target Securities and those who did not. Their ability to recover losses against manipulators are widely disparate under federal law.

Customers who purchased Target Securities share in the fund of customer property, receive reimbursement from SIPC to the extent that the fund of customer property cannot satisfy the customers' net equity claim, and have an action based on Rule 10b-5 or RICO against the manipulators for the difference in price between the Target Securities as manipulated, and the price of the Target Securities, post collapse, minus what the customer has received from the fund and SIPC. Indeed, a class action consisting only of purchasers and sellers of Target Securities has been certified and in consolidated with this case for purposes of discovery. *Cain v. Vigman, et al.*, Case No. CV 83-5674-AWT (Tx).

Customers who did not purchase the Target Securities also share in the fund of customer property and receive a

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to advance funds as required by federal statute to satisfy within the limit of the law the claims of investors whose broker-dealer was injured by the acts or fraudulent manipulations of others. Once SIPC has advanced monies to satisfy customers' claims, SIPC is subrogated to the claims of such customers, including claims against third parties.[39]

In this case, in July 1981, the net capital of FSSC and Sebag fell below the statutory limits and SIPC, pursuant to its statutory obligations, applied to the Court for the appointment of trustees to liquidate the firms under SIPA.[40]

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reimbursement from SIPC to the extent that their net equity claims are not satisfied by the fund. However, these customers could not pursue a Rule 10b-5 action against the manipulators, because they neither bought nor sold the Target Securities. With SIPC, this class of customers is virtually made whole, and SIPC succeeds to their rights. Nevertheless, under the District Court's decision, an anomaly is produced. This class of customers, whose rights SIPC now asserts, were victimized by conduct that undoubtedly could be made the subject of a federal RICO criminal prosecution, in which they would be the complaining witnesses. But because they are not "purchasers or sellers" of the Target Securities, neither they nor SIPC have a civil claim for relief for their losses under RICO, a result hard to justify under a statute that *expressly* provides for criminal *and* civil sanctions to vindicate its violation.

[39] 15 U.S.C. § 78fff-3(a).

[40] A net capital deficiency is determined in accordance with SEC Rule 15c3-1, 17 C.F.R. 240.15c3-1. Under the Rule, a broker-dealer's liabilities, or "aggregate indebtedness," may not exceed its net capital by more than 1500%. "Net capital" is

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Thereafter, SIPC, as is statutorily required, and as a direct result of the acts of Holmes and his confederates, advanced approximately $12.5 million to the Trustees of Sebag and FSSC to pay proper customer claims, to purchase securities in the open market, to satisfy proper customer claims, and to pay other costs and expenses of liquidation.[41] Further, SIPC is subrogated to the rights of each customer who received benefits by virtue of SIPC's advances.

V

ARGUMENT

A. RICO Provides A Critical Statutory Framework For SIPC To Protect Itself From Massive Stock Manipulations.

1. The Background Of RICO.[42]

The legislative history of RICO demonstrates beyond doubt that "Congress wanted to reach both 'legitimate'

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calculated as net worth less downward provisions for non-liquid assets, missing securities, inventory "haircuts" and other risk associated factors. C.R. 1310, p. 20 ¶ 32 n.7. On July 24, 1981, FSSC had a net capital deficiency of $2,634,976. C.R. 1310, p. 36, ¶ 86. The deficiency was caused in substantial part by the acts of Holmes. C.R. 1310, p. 34, ¶ 80.

[41] C.R. 1317, p. 109.

[42] *See generally* Blakey & Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts – Criminal and Civil Remedies*, 53 Temp. L. Q. 1009 (1980) (hereinafter "Basic Concepts"); Blakey, *The RICO Civil Fraud Action in Context*, 68 Notre Dame L. Rev. 237 (1982) (hereinafter "Civil Action"); Blakey & Cessar, *Equitable Relief Under Civil RICO*, 62 Notre Dame L. Rev. 526 (1987) (hereinafter "Equitable Relief").

and 'illegitimate' enterprises."[43] "[C]ourts and . . . commentators have persuasively and exhaustively explained why . . . RICO . . . [is not limited to] organized crime . . . ".[44] "The occasion for Congress' action was the perceived need to combat organized crime. But Congress for *cogent* reasons chose to enact a more general statute, one which . . . was *not* limited in application to organized crime."[45]

2. Standards Of Unlawful Conduct Under Civil RICO.

Congress directed that RICO "be liberally construed to effectuate its remedial purposes."[46] The directive is a "mandate."[47] Accordingly, the language of the statute is to be read in the same fashion, whether the suit is criminal or civil.[48]

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[43] *H.J., Inc. v. Northwestern Bell Telephone Co.*, 57 U.S.L.W. 4951, 4956 (June 26, 1989), citing *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495 (1985) ("not just mobsters").

[44] *Owl Const. Co. v. Ronald Adams Contractor, Inc.*, 727 F.2d 540, 542 (5th Cir.), *cert. denied*, 469 U.S. 831 (1984).

[45] *H.J., Inc.*, 57 U.S.L.W. at 4955 (emphasis added).

[46] 84 Stat. 947 (1970). *Sedima*, 473 U.S. 479 at 498 (1985); *Russello v. United States*, 464 U.S. 16, 27 (1983) ("[T]his is the only substantive federal criminal statute that contains such a directive . . . ").

[47] *Lou v. Belzberg*, 834 F.2d 730, 737 (9th Cir. 1987), *cert. denied*, 108 S. Ct. 1302 (1988) quoting *Sedima*, 473 U.S. at 492, n. 10.

[48] *H.J., Inc.*, 57 U.S.L.W. at 4954-56; *Sedima*, 473 U.S. at 489; *Cf. Northern Securities Co. v. United States*, 193 U.S. 197, 401

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At 18 U.S.C. Section 1962, Congress set forth "standards" of "unlawful" conduct, which are enforced through "criminal" and "civil" sanctions. Section 1963 sets out the criminal remedies, and Section 1964 establishes the civil remedies.[49] Because the civil scope of RICO is broader than its criminal scope, RICO is *not* primarily criminal and punitive, but primarily civil and remedial. As the Supreme Court recently stated: "Congress drafted RICO broadly enough to encompass a wide range of criminal activity, taking many different forms and likely to attract a broad array of perpetrators operating in many different ways."[50] RICO must be "read broadly . . . to effectuate its remedial purpose."[51] The burden of proof of showing a Civil RICO violation is proof by a preponderance of the evidence.[52]

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(1904) (Holmes, J., dissenting) ("The words cannot be read one way in a suit which is to end in fine and imprisonment and another way in one which seeks an injunction.").

[49] *Sedima*, 473 U.S. at 489; *Basic Concepts*, 53 Temp. L.Q. 1009 at 1021 n.71; *Civil Action*, 68 Notre Dame L.Rev. 237 at 243 n.20. *See also* 115 Cong. Rec. 6993 (1969) (statement of Sen. Hruska) ("The criminal provisions are intended primarily as an adjunct to the civil provisions, which I consider as the more important feature of the bill."); 116 Cong. Rec. 602 (1970) (statement of Sen. Hruska) ("The principal value of this legislation may well be found to exist in its civil provisions").

[50] *H.J., Inc.*, 57 U.S.L.W. at 4956.

[51] *Sedima*, 473 U.S. at 497-98; *United States v. Turkette*, 452 U.S. 576, 593 (1981) ("both preventive and remedial").

[52] *United States v. Cappetto*, 502 F.2d 1351, 1357 (7th Cir. 1974), *cert. denied*, 420 U.S. 925 (1975) (government suit); *Wilcox*

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3. Section 1964(c): RICO's Private Enforcement Mechanism.

The enforcement mechanism for private litigants under RICO, 18 U.S.C. Section 1964(c), provides:

> "Any person *injured in his business* or property by reason of a violation of section 1962 . . . may sue therefore in any appropriate United States district court and shall recover threefold the damages he sustains and the costs of the suit, including a reasonable attorney's fee."

18 U.S.C. § 1964(c) (emphasis added).

These provisions of RICO were modeled on, but are not identical to, the antitrust laws.[53] Like the antitrust laws, RICO creates "a private enforcement mechanism that . . . deter[s] violators and provide[s] ample compensation to the victims . . . "[54]

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v. First Interstate Bank of Oregon, 815 F.2d 522, 530-532 (9th Cir. 1987) (private suite); *Sedima*, 473 U.S. at 491 ("[N]o indication that Congress sought to depart from [preponderance]").

[53] S. Rep. No. 617, 91st Cong., 1st Sess. 81 (1967); H.R. Rep. No. 1549, 91st Cong. 2d Sess. 56-60 (1970). A private "treble-damages remedy [is needed] . . . precisely for the purpose of encouraging *private* challenges to antitrust violations." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344 (1979) (emphasis in original).

[54] *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 472 (1982). RICO and the antitrust statutes are well integrated. "There are three possible kinds of force which a firm can resort to: violence (or threat of it), deception, or market power." C. Kaysen & D. Turner, *Antitrust Policy* 17 (1959). RICO focuses on the first two; antitrust focuses on the on the third. *See Agency Holding Corp. v. Mally-Duff & Associates, Inc.*, 483 U.S. 143, 151

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B. The District Court Erred When It Held That Plaintiffs Did Not Present A Triable Issue Of Material Fact That Holmes And His Co-Conspirators' Conduct Was The Proximate Cause Of Its Damage Under 18 U.S.C. Section 1964(c).

1. The District Court Erred By Applying Section 10(b) "Loss Causation" Principles To Plaintiffs' RICO Claims.

Section 1964(c) provides for recovery for injury to property or business "by reason of" a violation of Section 1962. " '[B]y reason of' . . . simply imposes a proximate cause requirement on plaintiffs."[55] In *Haroco*, the Seventh Circuit held:

> "The criminal conduct in violation of section 1962 must . . . have injured the plaintiff's business or property. . . . This causation requirement might not be subtle, elegant or imaginative, but . . . it is based on a straightforward reading of the statute as Congress intended it to be read."[56]

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(1987) ("private attorneys general [for] a serious national problem for which public prosecutorial resources are deemed inadequate"); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 241, *reh'g denied*, 483 U.S. 1056 (1987) ("vigorous incentives for plaintiffs to pursue RICO claims"); *Sedima*, 473 U.S. at 493 ("[p]rivate attorney . . . provision . . . designed to fill prosecutive gaps"). *See generally* Note, *Treble Damages Under RICO*, 61 Notre Dame L. Rev. 526, 533-534 (1986) ("a powerful mechanism in the effort to vindicate the interests of those victimized by crime").

[55] *Haroco, Inc. v. Am. Nat'l Bank and Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985).

[56] *Haroco* at 398.

As such, a plaintiff, to recover under RICO, need only prove:

> (1) a violation of section 1962 . . . , and
>
> (2) an injury . . . resulting from some or all of the activity comprising the violation(s).[57]

The "by reason of" language appears in several similar federal statutes.[58] In *Mead v. Retail Clerks Int'l Ass'n Local No. 830*,[59] this Court considered Section 303 of the Labor Management Relations Act of 1947, 61 Stat. 158, which is especially relevant since it, too, was "drawn directly from the treble damage provision of the Clayton Act . . . ," and the Court found that the statute, like RICO, "was enacted as an alternative to" using the antitrust laws directly.[60]

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[57] *Marshall & Ilsley Trust Co. v. Pate*, 819 F.2d 806, 809 (7th Cir. 1987). Congress modeled Section 1964(c) on the antitrust acts. *Sedima*, 473 U.S. at 486-487. However, it did not want RICO unduly circumscribed by special antitrust proximate cause limitations. *Id.* at 498-499 ("previous proposal . . . [came] to grief . . . precisely because it could create inappropriate . . . obstacles in the way of . . . a private litigant . . . on questions such as 'standing to sue' and 'proximate cause.' ") (quoting ABA Comments at 115 Cong. Rec. 6995 (1969)); *Lou v. Belzberg*, 834 F.2d at 737 ("not . . . intended to incorporate all of the baggage")).

[58] *See e.g.*, 12 U.S.C. § 1975; 15 U.S.C. § 72; 19 U.S.C. § 1671d(b)(1); 22 U.S.C. § 2399(b)(a); 29 U.S.C. § 186; 31 U.S.C. § 3729; 41 U.S.C. § 119; 46 U.S.C. § 1227.

[59] 523 F.2d 1371 (9th Cir. 1975).

[60] *Id.* at 1376.

In *Mead*, this Court held that "the 'by reason of' language is read as incorporating common law principles of causation."[61] This Court further held that injury occurs 'by reason of' particular unlawful conduct if such conduct 'materially contributed' to the injury . . . or was a 'substantial factor' in bringing it about *'notwithstanding other factors contributed also. . . . '* "[62]

In contrast, causation principles under Rule 10b-5 are judicially restricted because of the "in connection with" requirement, the absence of an express private right of action under Section 10(b),[63] and the efforts of courts to prevent sellers of securities from acting as insurers of every downturn in the price of a buyer's stock.[64]

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[61] *Id.*

[62] *Mead*, 523 F.2d at 1376 (emphasis added). " 'Proximate cause' . . . is merely the limitation which the courts have placed upon the actor's responsibility for the consequences of the actor's conduct." W. Prosser & R. Keeton, *The Law of Torts* § 41 (5th ed. 1984). Under the "substantial factor" test, proximate cause is usually an issue for the jury, "unless the issue is so clear that reasonable persons could not differ." *Id.* That a defendant's conduct can be the legal or proximate cause of harm to a plaintiff if such conduct is a "substantial factor" in causing the harm is supported by the Restatement (Second) of Torts, Section 431. *See also In re Asbestos Cases*, 847 F.2d 523 (9th Cir. 1988); *Miller v. Schweickart*, 413 F. Supp. 1062, 1068 (S.D.N.Y. 1976). As summarized below, Holmes' conduct meets and exceeds the "substantial factor" test.

[63] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, *reh'g denied*, 423 U.S. 884 (1975).

[64] *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 718 (2d Cir.) (Meskill, J. dissenting), *cert. denied*, 449 U.S. 1011 (1980);

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The narrow "loss causation" principles that courts have imposed under Rule 10b-5,[65] however, are inapplicable in RICO cases.[66] The District Court below erroneously cited *Sperber v. Boesky*,[67] to support its finding that causation under RICO is, in substance, no different than "loss causation" under Section 10(b).[68] The Second Circuit in *Boesky* did not mention, much less discuss, the relationship between RICO causation and "loss causation" under Section 10(b). Instead, the Second Circuit simply stated

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Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1292 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

[65] *E.G., Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 (9th Cir. 1984).

[66] In *Bastian v. Petren Resources Corp.*, 699 F. Supp. 161 (N.D. Ill. 1988), the District Court speculated that "[w]hen the RICO violation is based upon a foundation of § 10(b) claims, *in most cases* the failure to prove loss causation under § 10(b) will result in a failure to prove proximate causation under § 1964(c) of RICO." *Id.* at 165 (emphasis added). Assuming *arguendo* the soundness of the dictum in *Bastian*, this case is unlike "most cases," including the simple misrepresentations made in *Bastian*. **This case involves an incredibly complex scheme to manipulate numerous securities by a variety of means over a long period of time by a large number of co-conspirators.** Further, plaintiffs' RICO claims are not based upon a "foundation of § 10(b) claims" but rather are based upon defendants' participation in a scheme of fraud in the sale of securities, wire fraud and mail fraud. Parenthetically, *Bastian* did not even address claims based on the predicate acts of wire and mail fraud.

[67] 849 F.2d 60 (2d Cir. 1988).

[68] Statement of Uncontroverted Facts and Conclusions of Law (Causation), C.R. 1342, p. 10 ¶ 23.

that "plaintiffs cannot show that their injuries were *proximately caused* either directly or indirectly by Boesky's racketeering violation."[69] The Second Circuit merely found that the injuries caused by the *Boesky* plaintiffs were too remote under traditional common law concepts of proximate cause. As such,*Boesky* supports the proposition that common law proximate cause is the measure here.[70]

The traditional common law of causation relating to intentional torts as applicable here is found in the Restatement (Second) of Torts at Section 435A which states:

> "A person who commits a tort against another for the purpose of causing a particular harm to the other is liable for such harm if it results, whether or not it is expectable, except where the harm results from an outside force the risk of which is not increased by the defendant's act."[71]

Under this doctrine, since Holmes participated in both the Bunnington and Aero Systems stock manipulations, as a part of the scheme shown below, the harm which

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[69] *Boesky*, 849 F.2d at 64 (emphasis added). *See Mead*, 523 F.2d at 1376); *Haroco, Inc.*, 747 F.2d at 398; *Brandenburg v. Seidel*, 859 F.2d 1179, 1189 (4th Cir. 1988). *See also Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. at 497 n.15 (approving recovery for both direct and ultimate harm flowing from defendant's conduct); *see* Section V.C.2 at pp. 46-49, *infra*.

[70] Accord Zervas v. Faulkner, 861 F.2d 823, 832-835 (5th Cir. 1988); *Brandenburg v. Seidel*, 859 F.2d 1179, 1187-1190 (4th Cir. 1988).

[71] The authors state that the rules of cause-in-fact for negligent conduct apply in the case of intentional conduct. Restatement 2d of Torts, § 870, comment 1.

resulted from those illegal acts – regardless of whether or not Holmes expected such harm – is Holmes' responsibility.[72]

2. The Court Found That There Was An Issue Of Material Fact Whether Holmes' Conduct Was The Proximate Cause Of Injury To SIPC And The Trustees.

The District Court found genuine issues of material fact concerning whether Holmes participated in a conspiracy[73] to violate RICO Sections 1962(a), 1962(b) and 1962(c), and that there was an issue present as to whether the alleged predicate acts, including fraud in the sale of securities, *caused* injury to SIPC and the Trustees.[74] Nevertheless, the District Court found that Holmes' conduct was not the "legal" or "proximate" cause of injury to the

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[72] Holmes will argue that even if he participated in the scheme (*i.e.*, intentionally invaded the legally protected interests of the Target Securities stockholders), SIPC is too remote to recover. In such a case, the Restatement (Second) of Torts at Section 435B, provides that Holmes' intent to commit the invasion, Holmes' degree of moral wrong in acting, and the seriousness of the harm which Holmes intended "are important factors in determining whether he is liable for resulting unintended harm." *See also Miller v. Schweickart*, 413 F.2d Supp. at 1068 (causation analysis examines "the extent to which the defendants" conduct created a continuous and active potential for harm").

[73] The conspiracy alleged in the First Amended Complaint, and in which the District Court found triable issues for purposes of these motions in composed of, *inter alia*, Holmes, Aero Systems, Lugo and Vigman. C.R. 1317, p. 1.

[74] Order Granting Summary Judgment (RICO claims) C.R. 1343, pp. 2-3, ¶¶ 5, 6, 8.

plaintiffs under RICO.[75] This determination is both irreconcilable as a matter of law with the District Court's RICO conspiracy finding and is, based on the evidence submitted, independently, patently and factually erroneous.

The law of conspiracy is so well-settled that it hardly needs citation; one is liable for the acts of a co-conspirator done in furthering a common plan, *i.e.*, all conspirators are liable for the acts of their co-conspirators.[76] Thus, since evidence of a conspiracy was found to exist, and three of the conspirators are Holmes, Lugo and Vigman,[77]

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[75] *Id.*; Order Granting Summary Judgment (Causation) C.R. 1344, pp. 1-2, ¶¶ 1-4. Even if the "loss causation" principles relied upon by courts under Section 10(b) were applied. Holmes is liable both as a direct participant and aider and abettor in the overall scheme to manipulate the Target Securities. *Kafton v. Baptist Park Nursing Center, Inc.*, 617 F. Supp. 349, 350-51 (D. Ariz. 1985) (In 10b-5 case "causal nexus is not between a particular misrepresentation and plaintiff's loss, but between the entire functioning scheme and the injury").

[76] *See e.g. Kashi v. Gratsos*, 790 F.2d 1050, 1054-1055 (2d Cir. 1986); *Beltz Travel Serv. Inc. v. Int'l Air Transp. Ass'n*, 620 F.2d 1360, 1367 (9th Cir. 1980). *See generally Nalle v. Oyster*, 230 U.S. 165, 182 (1913) common law civil conspiracy; well-settled rule injury from overt act actionable); *Halberstam v. Welch*, 705 F.2d 472, 487 (D.C. Cir. 1983) (conspiracy to commit burglary, death by overt act of coconspirator actionable); *Rice v. Janovich*, 109 Wash.2d 48, 49-52, 58-62, 64-67, 742 P.2d 1230, 1232, 1236-38, 1239-40 (1987) (injury from over act of co-conspirator, even if not predicate act, actionable).

[77] The Holmes, Lugo and Vigman relationship goes back to 1966 and 1967. C.R. 1317, pp. 9, 15. Vigman is Holmes' "confidante" and "financial advisor" and exerts substantial influence over Holmes to this day. *Id.* pp. 6-15; Lugo's relationship with Holmes and Vigman is extremely close. *Id.* pp. 15-17.

acts of either or both Lugo[78] and Vigman[79] in furtherance of the conspiracy place liability on Holmes as if those acts were his own.

The evidence of the acts of co-conspirator Lugo that contributed to the collapse is legion. Lugo sold Aero Systems stock at manipulated prices to purchase extensive holdings of Bunnington and Aerosonics stock that were declining in price due to selling by other market makers.[80] At the time of sales of Aero Systems stock by Lugo at FSSC, the cash flow into FSSC was the greatest in its history.[81] Lugo contributed to the Aero Systems manipulation by "leading the bid," a common manipulative technique, and by FSSC's dominance and control over the market in Aero Systems stock between April

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[78] Lugo was disciplined and suspended by the Securities Exchange Commission. C.R. 1317, pp. 15 & 24. He was also censured and fined by the NASD in a proceeding in which the NASD alleged that Lugo manipulated the price of Bunnington stock. *Id.* p. 28.

[79] All elements of a RICO violation are present in this case, including the perpetration of a pattern of racketeering activity over a 15 years time span. These predicate acts include acts resulting in the debarment of Vigman from association with any securities broker/dealers (C.R. 1317, pp. 16-17), spin-off transactions resulting in administrative findings that Vigman violated the Securities Act of 1933 and the Securities Exchange Act of 1934 (*Id.* p. 20), civil consent decrees against Vigman relating to securities later swapped for Aero Systems stock (*Id.* pp. 29-37) and Vigman's criminal conviction for securities fraud relating to transactions in warrants of Holmes' company, Aero Systems. *Id.* p. 11.

[80] C.R. 1310, p. 6.

[81] *Id.* at p. 8.

1979 and April 1981.[82] Lugo falsified FSSC's looks and records by posting FSSC's liabilities to incorrect accounts in order to avoid detection in cursory NASD examinations.[83] Lugo also "parked" hundreds of thousands of dollars in securities during April and May of 1981 to allow FSSC to remain in business,[84] thereby increasing profitability to Holmes, Vigman and others. As a key factor in the manipulations, Lugo used FSSC to dry up the market supply of the Target Stocks, which eventually led to FSSC's demise when excessive inventories of Bunnington and Aerosonics stock drove FSSC into liquidation.[85]

Further, the facts presented to the District Court show that co-conspirator Vigman committed acts in furtherance of the plan to manipulate Bunnington stock.[86] Vigman himself had a securities account at FSSC with Lugo.[87] When the manipulated price of Aero Systems stock was near its artificially inflated zenith, Vigman sold

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[82] *Id.* at p. 14.

[83] *Id.* at 22.

[84] *Id.* at p. 24.

[85] *Id.* at p. 19.

[86] Vigman was a major shareholder of Bunnington at different times during the long history of the scheme. C.R. 1317, p. 31, n.34. Further, Vigman, with Holmes and Aero Systems, engineered the complex DCS transaction in 1976 by which Bunnington obtained the only viable asset of Vigman's defunct company and by which Vigman exchanged worthless stock for thousands of valuable shares of Aero System stock. *Id.* pp. 28-42.

[87] C.R. 1310, pp. 18 & 50.

181,565 shares for $1,148,963.13 through Lugo at FSSC.[88] Many of the shares were restricted from sale; however, Holmes materially assisted Vigman in lifting those restrictions in order to enrich his co-conspirator.[89] Lugo did not pay Vigman for these transactions until weeks after they had taken place, thereby providing Lugo with an estimated $223,000 to $278,075 in interest-free money for FSSC's trading account – money used to buy up the ever increasing supply of Bunnington and Aerosonics stock.[90] Vigman's sales of Aero Systems stock were timed along with Holmes' false press releases to maximize the price of Aero Systems stock.[91] These factors, taken together, show that Holmes, Vigman and Lugo acted in concert to manipulate these Target Securities, to the ultimate detriment of FSSC, Sebag, SIPC and the investing public.

Thus, even ignoring the acts of Holmes himself, since he is a co-conspirator, he is, *as a matter of law*, responsible for the damages caused by the acts of his co-conspirators.[92]

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[88] *Id.* at p. 15.

[89] *Id.* at pp. 16-17.

[90] *Id.* at pp. 18-19.

[91] *Id.* at p. 15.

[92] In a vain attempt to bolster his case and claim that plaintiffs' damages were caused by an "intervening cause," the District Court accepted a Holmes finding that the net capital violations were caused by the brokerage firms' management." C.R. 1342, p. 5, ¶ 21. This finding erroneously isolates Holmes from the acts of his co-conspirators and ignores not only the District Court's finding of conspiracy but the substantial issues

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3. Holmes Was A Principal, Co-Conspirator, And Aider And Abettor In The Bunnington Stock Manipulation That Holmes Admits Was a Substantial Cause Of Plaintiffs' Loss.

Holmes not only concedes, but affirmatively asserts that the price of Bunnington stock was "artificially inflated," and that the large concentration of Bunnington and Aerosonics securities in the FSSC and Sebag inventory accounts was a "substantial cause of the demise of the brokerage houses."[93] Also, in adopting the fact findings prepared by Holmes, the District Court found, *inter alia*, that net capital deficiencies at FSSC and Sebag resulted from "undue concentration" of Bunnington and Aerosonics stock.[94] Indeed, the evidence shows that the "undue concentration" of Bunnington stock was a key part and a natural result of the manipulation of Bunnington stock.[95]

Thus, if there is evidence to go to a jury that Holmes participated in the Bunnington manipulation, Holmes is liable by virtue of his own findings and admissions for

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of fact of the conspiracy as well. Holmes and the District Court conceded that "managment" caused the loss; the jury must decide whether or not Holmes conspired with "management" to cause it.

[93] C.R. 1281, pp. 12-13 (citing the NASD report concerning the failures of FSSC and Sebag); C.R. 1326, p. 34. The evidentiary record also supports the finding that Bunnington stock was manipulated. C.R. 1309, pp. 17-18, ¶ 22.

[94] C.R. 1342, p. 5, ¶ 20.

[95] C.R. 1310, p. 34, ¶ 81; p. 39, ¶ 96; p. 40, ¶ 99; p. 41, ¶ 101.

the net capital deficiencies and consequent loss to plaintiffs.

The overwhelming evidence that must go to the jury is that Holmes did participate in, and provided substantial assistance to, Vigman, Lugo and other co-conspirators[96] in connection with the manipulation of Bunnington stock:

> (1) Holmes traded heavily in Bunnington stocks through both broker-dealer transactions and private placements with Bunnington, purchasing Bunnington stock in large blocks from FSSC while selling in small lots through other broker-dealers in sixty-six separate carefully timed transactions. Holmes' trading pattern had the effect of stimulating a demand interest for Bunnington by constricting the floating supply; selling in small lots expanded the supply gradually so as not to cause a dramatic decline in the price.[97] Holmes' active trading in Bunnington yielded virtually no individual profits, and thus was intended to influence the market demand for Bunnington, thereby assisting Lugo and Vigman in the manipulation of Bunnington stock;[98]

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[96] The Bunnington manipulation required substantial assistance from defendants Isadore Diamond, who is Vigman's brother-in-law and the Chairman of the Board of Bunnington (C.R. 1317, p. 34, n.38; pp. 36 & 37), and Gordon McNeil, the President of Bunnington. The evidence of the manipulative activities of Diamond and McNeil were not material to these motions and thus not before the District Court at the time of hearing.

[97] C.R. 1310, pp. 37-39, ¶¶ 90-96.

[98] *Id.* pp. 39-41, ¶¶ 97-101. The only *sale* of Bunnington made by Holmes through FSSC was the "parking" transaction. *Id.*, pp. 25-29, ¶¶ 48-63.

(2) Holmes' trading through Lugo at FSSC dominated and controlled the market in Bunnington, a classic element of stock manipulation;[99]

(3) As of late April 1981, FSSC has a small, undetected net capital deficiency.[100] In order to obtain artificial compliance with SEC net capital regulations, defendant Lugo falsified the books and records of FSSC by, *inter alia*, "parking" significant volumes of FSSC inventory stocks such as Bunnington in customer accounts, including Holmes' account.[101]

On May 20, 1981, a purchase order for 5,000 shares of Bunnington stock was entered in Holmes' account.[102] The transaction "parked" shares in Holmes' account in order to artificially increase FSSC's net capital.[103] This parking transaction was significant not only because it was a riskless transaction for Holmes,[104] who did not pay for the shares, but because it reveals Holmes' complicity, participation and cooperation in keeping the manipulation scheme together at a time of crisis.

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[99] *Id.* pp. 39-40, ¶¶ 97-99; C.R. 1317, p. 94.

[100] C.R. 1310, p. 21, ¶¶ 34-35.

[101] *Id.* pp. 21-22, ¶¶ 37-38; pp. 23-29, ¶¶ 43-63. By placing FSSC inventory stocks in customer accounts, FSSC reduced the minimum net capital requirements imposed by SEC regulations. Inventory stocks, unlike customer account stocks, are discounted in value in order to assess net capital compliance. This discount is commonly referred to as a "haircut", *Id.* p. 20, ¶ 32 n.7.

[102] *Id.* p. 25, ¶ 49.

[103] *Id.* pp. 25-30, ¶¶ 48-63.

[104] *Id.* p. 26, ¶ 53.

The parking of stocks at FSSC did not merely mask existing damage, as the District Court found,[105] but created dramatic independent losses to FSSC.[106] By parking large volumes of securities in April and May of 1981, Lugo was able to conceal FSSC's net capital deficiency and continue to operate the firm until July 24, 1981.[107] The increased losses associated with the scheme to conceal FSSC's net capital deficiency were estimated conservatively at $1,855,382.[108]

(4) The *modus operandi* of publishing false and misleading information to public investors was utilized regularly by Holmes and the other defendants.[109] In May of 1981, Holmes participated directly in the Bunnington manipulation when Bunnington issued one of its many false and misleading press releases, and Holmes published it as fact by wire directly to Moore Schley

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[105] C.R. 1342, p. 7, ¶ 35.

[106] C.R. 1310, p. 24, ¶ 45.

[107] *Id.* p. 24, ¶ 47; pp. 34-35, ¶ 81.

[108] When the price of Target Security Bunnington plummeted in late July 1981 from approximately $11 per share to $2.50 per share, FSSC could no longer mask the net capital deficiency that had been growing since April 1981 and the brokerage house collapsed. Moreover, the failed efforts by Holmes, Lugo, Vigman and other co-conspirators to perpetuate the manipulation of FSSC through July 1981 toppled Sebag as well. As of May 29, 1981, Sebag carried only $110,000 of its inventory in manipulated stocks Aerosonics, Bunnington, Dash and Osrow. C.R. 1310, p.30, ¶ 64. Thereafter, through Lugo's transfers to Sebag, Sebag increased its inventory in those stocks by more than $7 million, forcing the firm into liquidation on July 27, 1981. *Id.* pp. 30-31. ¶¶ 65-68.

[109] *See e.g.*, C.R. 1317, pp. 58-83; pp. 95-97; pp. 104-105.

Cameron & Company ("Moore Schley"),[110] a broker/dealer in New York.[111]

(5) Holmes personally promoted Bunnington stock through Moore Schley, introduced Moore Schley to Bunnington principals who sold Bunnington stock through Moore Schley and discussed the availability of financing for Bunnington with Moore Schley;[112]

(6) Holmes tried to support the price of Bunnington stock even after the collapse of FSSC and Sebag. One week after the collapse he borrowed $600,000 to support additional Bunnington purchases and secured the loan with 528,000 shares of manipulated Aero Systems stock;[113] and

(7) Holmes profited from insider information from Bunnington.[114]

Holmes had a compelling motive to artificially prop up Bunnington's price: greed. For $100,000 in September of 1979, Holmes bought a Bunnington debenture convertible into 40,000 shares of Bunnington common stock (*i.e.* for $2.50 per share).[115] After the two year holding period the restricted stock would have become unrestricted and saleable on the open market (*i.e.* in September 1981). About the time he bought the convertible debenture,

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[110] Moore Schley was also the broker-dealer who actively assisted Holmes in the successful unlawful manipulation of Holmes' Aero Systems stock. C.R. 1317, pp. 71-81.

[111] *Id.* p. 71.

[112] *Id.* pp. 95-97.

[113] *Id.* p. 98.

[114] *Id.* pp. 95-97.

[115] *Id.* p. 92.

Holmes began trading Bunnington in a manner that contributed to the manipulated price rise of Bunnington stock.[116] Holmes also touted Bunnington stock,[117] published a false laudatory press release about Bunnington,[118] and parked Bunnington stock with Lugo at FSSC.[119] During this period (August 1979 through July 1981), Bunnington stock rose from approximately $3.50 per share to $12.25 per share.[120] All Holmes had to do was keep the price up for two more months (*i.e.* from July through September) and his 40,000 shares would be worth approximately one- half million dollars. Despite all of his efforts, and those of his co-conspirators Lugo and Vigman, Holmes did not quite make it.[121]

Of course, Holmes will vociferously deny all of the above, and will provide numerous excuses. But he has admitted – at least for purposes of his motions, and this

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[116] C.R. 1310, pp. 37-39, ¶¶ 90-96; C.R. 1296, Ex. 3863.

[117] C.R. 1317, pp. 95-97.

[118] *Id.* p. 96.

[119] C.R. 1310, pp. 25-29, ¶¶ 48-63.

[120] C.R. 1296, Ex. 3863.

[121] On July 24, 1981, FSSC held 62,043 shares of Bunnington at an average cost of $11.0456 per share. By reason of a sudden deflation in the price of Bunnington, the market value of those shares on the date the liquidation proceeding commenced was $2.50 per share. C.R. 1310, p. 36, ¶ 88. On July 27, 1981, Sebag held 73,640 shares of Bunnington at an average cost of $10.89 per share. The Market value of the shares on the date the liquidation proceeding commenced was $2.50 per share (*Id.* p. 32, ¶¶ 72-73). Thus, the total trading losses to FSSC and Sebag in Bunnington alone were approximately $1.15 million.

Court must accept as a fact – that *the Bunnington manipulation was a substantial contributing factor* to the injuries to the plaintiffs; and if Holmes did what plaintiffs say he did, Holmes caused the loss, or at least it must be for jury to say that he did not. Under these facts, a court simply cannot decide that Holmes is not liable to plaintiffs as a matter of law.

4. The Manipulation Of Aero Systems Stock By Holmes And His Co-Conspirators Was The Linchpin Of The Scheme To Manipulate Bunnington And Aerosonics Stocks.

Apparently, the District Court viewed Holmes' manipulation of Aero Systems stock as an isolated event and erroneously accepted his argument that that manipulation had "no impact" on the net capital deficiencies;[122] *i.e.*, the Court considered Holmes' primary role in the Aero Systems manipulation in isolation.[123] The law,

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[122] C.R. 1342, p. 5, ¶ 22. Holmes also argued, and the Court accepted, that because the brokerage houses' inventories of Aero Systems stock were not material, Holmes' Aero Systems manipulative activities did not contribute to the collapse of FSSC and Sebag. *Id.* p. 8, ¶ 7.

[123] Holmes conceded for purposes of the motion that he participated in the manipulation of Aero Systems securities. C.R. 1281, p. 11. As well he should; it is difficult to see how a trier of fact could find otherwise in light of the literally overwhelming evidence of Holmes' carefully calculated and intense "hyping" of the stock and the "CD-3000," Aero Systems' so-called "fuel savings" device. C.R. 1317, pp. 42-83. Characteristically, his misrepresentations to the public continued when, after the summary judgments were granted on the narrow legal grounds herein, and despite the District Court's clear

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however, is indisputable " . . . that 'a conspiracy [is] not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole.' "[124] The Court failed to consider what part Holmes' manipulation of Aero Systems had in the entire scheme.[125]

The manipulation of Aero Systems stock was critical to the excess inventory build-up in Bunnington and Aerosonics stocks at Sebag,[126] and thus the scheme to manipulate and falsely inflate the Bunnington stock (as well as

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findings of fact that Holmes' conduct was sufficiently questionable that it should go to a jury, Holmes issued a press release to his stock buying public on November 2, 1988, stating that he had been "vindicated". C.R. 1364, Ex. "A". Incredibly, Holmes also has threatened plaintiffs with an action for malicious prosecution despite the overwhelming evidence of Holmes' participation in, and engineering of, the fraudulent schemes. C.R. 1364, Ex. "C".

[124] *Beltz*, 620 F.2d at 1366, citing *United States v. Patten*, 226 U.S. 525, 544 (1913).

[125] Holmes contends that the manipulation of Aero Systems securities satisfies the "but for" causation requirement but fails to support "loss causation." C.R. 1326, p. 27. However, as shown above, loss causation principles do not apply to RICO claims such as this. *See supra*, n.66. Further, the manipulation of Aero Systems securities directly funded and manipulation of Bunnington and other Target Securities. C.R. 1310, p. 33, ¶¶ 76-79. Each manipulation was part of a scheme, not unrelated acts separated by intervening forces as Holmes would conveniently assert.

[126] Holmes' role in the manipulation of Aero Systems stock allowed Sebag to obtain substantial loans from First Interstate Bank which were used to acquire large inventory positions in Bunnington and Aerosonics securities. *Id.*

the others). By April 24, 1981, when FSSC first experienced a net capital deficiency, the manipulation of Aero Systems had succeeded.[127] In April and May of 1981, Holmes' "financial advisor" and co-conspirator Vigman sold massive volumes of inflated Aero Systems stock to FSSC for proceeds of $1,148,963.[128] Lugo immediately resold the Aero Systems stock and then delayed payment to Vigman, thereby allowing FSSC with those funds to acquire large inventory positions in Bunnington, Aerosonics and Creditbank securities.[129] As a direct result of Holmes' manipulation of Aero Systems stock and the April-May 1981 sales of Aero Systems at inflated prices from Vigman to Lugo to the public, Lugo was able to purchase the substantial volumes of these other Target Securities.[130] The inventory increase, predominantly in Bunnington and Aerosonics stock was necessary to maintain those stocks' prices at the artificially inflated level, since considerable sell pressure was experienced at that time. As Holmes admits, the escalation of inventory led to the demise of FSSC and Sebag.[131]

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[127] C.R. 1310, p. 21. Holmes' media campaign to inflate the price of Aero Systems stock resulted in a price increase in excess of 137% from September 1980 through May 1981, C.R. 1309, p. 14, ¶ 15.

[128] C.R. 1310, p. 18, ¶ 26.

[129] *Id.* pp. 17-19, ¶¶ 24-29.

[130] *Id.* p. 19, ¶ 30. When FSSC acquired substantial positions in Bunnington, Aerosonics and Creditbank, the book value of FSSC's inventory exceeded its capitalization by more than 300%. *Id.* p. 19, ¶ 30.

[131] C.R. 1281, pp. 12-13.

Thus, the evidence shows beyond doubt that it is a jury question with respect to the effect of Holmes' manipulation of the Aero Systems stock in furtherance of the scheme to manipulate the market prices of Bunnington and Aerosonics stock (which, as Holmes admits, caused the collapse of the brokerage houses).[132]

C. The District Court Erred In Granting Summary Judgment To Holmes When It Held That SIPC Must Be A "Purchaser Or Seller" Of Securities To Maintain An Action Under 18 U.S.C. Section 1964(c) For Conduct Consisting Of (a) "Any offense . . . Involving Fraud In The Sale Of Securities . . . Punishable Under Any Law Of The United States," (b) Wire Fraud Or (c) Mail Fraud In Violation Of 18 U.S.C. Section 1962.

1. Application Of RICO: No Purchaser/Seller Limitation.

Interpretation of RICO begins with its text,[133] and structure as well as language is important.[134] The various ways that RICO's substantive standards may be violated each requires a "pattern of racketeering activity."[135] 18

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[132] In "cases of this kind, it is for the jury, as trier of fact, to determine the question of causation." *Costner v. Blount Nat'l Bank of Maryville*, 587 F.2d 1192, 1195 (6th Cir. 1978) (multiple factors in conflict under Bank Holding Company Act).

[133] *H.J., Inc.*, 57 U.S.L.W. at 4953; *United States v. Monsanto*, 57 U.S.L.W. 4826, 4827 (June 22, 1989); *Russello*, 464 U.S. at 20 (citing *Turkette*, 452 U.S. at 587).

[134] *Russello*, 464 U.S. at 22-23; *United States v. Turkette*, 452 U.S. at 582; 587.

[135] 18 U.S.C. §1962(a)-(d). *Jarvis v. Regan*, 833 F.2d 149, 152 (9th Cir. 1987) *cert. denied*, 108 S. Ct. 2851 (1988) ("common thread").

U.S.C. Section 1961(1), which includes RICO's predicate acts, defines "racketeering activity" to mean:

> "(B) any act . . . under . . . title 18 . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud) . . . "
>
> • • •
>
> "(D) any offense involving . . . fraud in the sale of securities . . . punishable under any law of the United States. . . . "

These substantive standards are enforced through 18 U.S.C. Sections 1963 (criminal) and 1964 (civil). Section 1964 defines who may sue ("any person") and who may be sued ("any person"), what the person may sue for (injury "to business or property"), and when such injury is compensable ("by reason of a violation"). RICO, therefore, is explicit and comprehensive in its articulation of its substantive standards and the structure of its remedial framework.

a. The Language Of 18 U.S.C. Section 1964(c) Is Not Limited By A Purchaser/Seller Requirement.

Section 1962 is enforced by private suits through 18 U.S.C. Section 1964(c), which provides that "[a]ny person injured in his business or property by reason of a violation of section 1962" may sue. The definition of "person" includes "any individual or entity capable of holding a legal or beneficial interest in property."[136] The plain text of RICO does not impose "purchaser or seller" limitations

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[136] 18 U.S.C. § 1961(3).

on "any person."[137] Had Congress wanted to narrow the class of persons entitled to sue to enforce RICO's remedial provisions, it could have narrowed the definition of "person" in this section; Congress could have "narrowed the sweep of the definition by inserting a single word".[138] " 'The short answer [to the contention that RICO is limited by purchaser-seller limitations] is that Congress did not write the statute that way.' "[139]

Therefore, it was improper for the District Court to read into the statute a "purchaser or seller" limitation that the courts have implied for private civil actions arising under Section 10(b) and Rule 10b-5 of the Exchange Act.[140]

Congress explicitly set out the only limitations on civil recovery under RICO. The "person" must show that "his business or property" was "injured."[141] "In addition,

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[137] *Bankers Trust Co. v. Rhoades*, 859 F.2d 1096, 1099 (2d Cir. 1988), *cert. denied*, 109 S. Ct. 1642 (1989) ("no special limitation on standing").

[138] *See Turkette*, 452 U.S. at 581 (definition of "enterprise").

[139] *Monsanto*, 57 U.S.L.W. at 4829 ("any property" does not exclude funds for legal fees) (quoting *United States v. Naftalin*, 441 U.S. 768, 773 (1979)).

[140] *Compare H.J., Inc.*, 57 U.S.L.W. at 4954-4956 ("pattern" not limited to organized-crime-type perpetrator); *Sedima*, 473 U.S. at 495 ("any person" not limited to "mobsters"); *Russello*, 464 U.S. at 21-22 ("any interest" not limited to "interest in enterprise"); *Turkette*, 452 U.S. at 580-81 ("any enterprise" not limited to "illegal enterprise"); *Lou v. Belzberg*, 834 F.2d at 736 ("exclusive" may not be read into Section 1964(c)).

[141] *First Pac. Bancorp. Inc. v. BRO*, 847 F.2d 542, 547 (9th Cir. 1988).

the plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation. . . . But the statute requires no more than this."[142]

b. "Fraud In The Sale Of Securities" Under RICO Does Not Include Purchaser/Seller Limitations.

Since the judiciary implied a private claim for relief in Rule 10b-5, circumscribing it by an implied standing rule may be appropriate.[143] However, the private right of action under Civil RICO is *express*, and a judicial limitation on its scope by implied standing rules is improper. To require Civil RICO plaintiffs to be purchasers or sellers ignores the clear teaching of *Blue Chip Stamps:* the "[j]udiciary may not circumscribe [an express claim for relief] . . . because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability."[144] *H.J., Inc.'s* and *Monsanto's* teachings are also relevant here: "RICO's language supplies no ground to believe that Congress meant to impose such a limit on the Act's scope."[145] "[T]he statute, as presently written, cannot be read any other way."[146] *Sedima*, too, is

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[142] *Sedima*, 473 U.S. at 496-497; *see Marshall & Ilsley Trust Co. v. Pate*, 819 F.2d at 807 ("wrong to require a plaintiff to show" more).

[143] *Blue Chip Stamps*, 421 U.S. at 749.

[144] *Id.* at 748.

[145] *H.J., Inc.*, 57 U.S.L.W. at 4955 ("pattern" not limited by organized crime).

[146] *Monsanto*, 57 U.S.L.W. at 4829 ("any property" does not exclude funds for legal fees).

unequivocal: liability under RICO must not be judicially limited: "it is a form of statutory amendment [in] appropriately undertaken by the courts."[147] "[C]orrection must lie with Congress," if it is "a defect."[148] "[R]ewriting . . . [RICO] is a job for Congress, if it is so inclined, and not for [a court]."[149]

Accordingly, "any offense . . . involving fraud in the sale of securities . . . punishable under any law of the United States," the operative RICO provision, is not limited by "purchaser or seller" standing requirements.[150]

Although the plain language of RICO and the Supreme Court's teaching preclude judicially imposed limitations on standing under RICO, some courts nevertheless impose artificial standing requirements on the statute. *International Data Bank, Ltd. v. Zepkin*[151] is the principal decision in opposition. The Fourth Circuit in *Zepkin* concedes that Congress did not *expressly* limit RICO by "purchaser or seller" limitations, noting the absence not only of "purchaser-seller" language but also of Section 10(b)'s "in connection with" causation standard. Yet the *Zepkin* court argued that explicit statutory

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[147] *Sedima*, 473 U.S. at 500 (injury not limited to racketeering type).

[148] *Id.* at 499.

[149] *H.J., Inc.*, 57 U.S.L.W. at 4956.

[150] *Warner v. Alexander Grant & Co.* 828 F.2d 1528, 1530 (11th Cir. 1987) ("The federal RICO statute has no requirements analogous to the 'purchase or sale' requirement of the federal securities law.").

[151] 812 F.2d 149 (4th Cir. 1987), *cert. denied*, 108 S. Ct. 698 (1988).

language was required in RICO to overcome judicially imposed limitations on private actions under Rule 10b-5.[152] *Zepkin* is fundamentally misguided, misreads the statutory scheme of RICO, and reflects bad policy.[153]

First, *H.J., Inc., Monsanto,* and *Sedima* squarely hold that RICO's express text structure and legislative history, not its silence in the text or legislative history, control the interpretation of RICO.[154] RICO must be liberally construed, and its remedial purpose is to be enhanced, not retarded.[155] The Fourth Circuit ignores the implications of the liberal construction clause for its narrow interpretation of the statute. Indeed, *Zepkin* does not even address 18 U.S.C. Section 1964, the civil provision that, in fact, *expressly* deals with standing, injury, and causation. As *Sedima* noted, moreover, it was expressly to avoid such narrow standing limitations on RICO's remedies that the legislation was enacted outside of the antitrust statutes.[156] By reading such limitations back into RICO, the Fourth Circuit "create[s] exactly the problems Congress sought to avoid."[157]

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[152] *Zepkin*, 812 F.2d at 152.

[153] *See Federenko v. United States*, 449 U.S. 490, 513 (1981) (A court is "not at liberty to imply . . . a condition which is opposed to the explicit terms of the statute . . . To [so] hold . . . is not to construe the Act but to amend it.") (quoting *Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21, 38 (1934)).

[154] *H.J., Inc.* 57 U.S.L.W. 4951 at 4953; *Monsanto*, 57 U.S.L.W. 4826 at 4827-4829; *Sedima*, 473 U.S. at 495 n.13.

[155] *Sedima*, 473 U.S. at 497-498.

[156] *Id.* at 498.

[157] *Id.* at 499. Some overlap between statutes "is neither unusual nor unfortunate." *S.E.C. v. Nat'l Secs.*, 393 U.S. 453, 468

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Rule 10b-5 standing limitations are inapplicable to RICO on another more fundamental ground. By itself, the implied claim for relief of Rule 10b-5 seeks only private *civil* redress. RICO, however, seeks to make effective the substantive standards of the statute through both criminal and civil sanctions. The substantive standards of RICO reflect the substantive elements of its predicate acts, each of which is crime. RICO fills this objective civilly through a private attorney general enforcement mechanism.[158] The purchaser/seller limitation of Rule 10b-5 is imposed only for private civil actions. The violation of Rule 10b-5 that constitutes a predicate act under RICO, however, is a *criminal* securities fraud. "Offense . . . punishable" "obviously refers to [the] criminal" provisions of the securities statutes.[159]

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(1969). Indeed, the securities statutes themselves envision it. *See e.g.*, 15 U.S.C. § 78bb (a)("rights and remedies . . . in addition" to "any and all other rights" that exist).

[158] *Agency Holding Corp.*, 483 U.S. at 151; *Shearson/American Express Inc.*, 482 U.S. at 241; *Sedima*, 473 U.S. at 493.

[159] *Trane Co. v. O'Connor Secs.*, 718 F.2d 26, 29 (2d Cir. 1983). *See* Section 32(a) of the Securities Exchange Act of 1934, 84 Stat. 904 ("willfully violates"). The standards of Section 32(a) are not limited by "purchaser-seller" limitations. *United States v. Charmay*, 537 F.2d 341, 349 n.11 (9th Cir.) *cert. denied* 429 U.S. 1000 (1976). ("In a criminal prosecution, the standing problem is, of course, not present and Rule 10b-5 is applicable if the conduct charged falls within the Rule's prohibition."). *See also United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979) (*Blue Chip Stamps* does not limit criminal provisions); *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *cert. denied*, 464 U.S. 863

(Continued on following page)

Plaintiffs under RICO, especially public benefit corporations such as SIPC, act as private prosecutors.[160] Had Congress wanted to impose "purchaser-seller" standing limitations on this civil enforcement mechanism, it could have done so with appropriate language. Congress was well-aware of the overlap between RICO and the securities statutes, as the point was specifically drawn to its attention.[161]

Forcing Civil RICO into a purely private law model, as the Fourth Circuit does in *Zepkin*, misconceives Civil RICO's important *public* law functions.[162]

c. Mail And Wire Fraud Do Not Include Purchaser/ Seller Limitations.

No language in the mail or wire fraud statutes warrants reading into them "purchaser or seller" limitations.

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(1983) ("It is only because the judiciary . . . created a private cause of action . . . that standing . . . has become a pivotal issue").

[160] *See Lou v. Belzberg*, 834 F.2d at 739 ("encourage enforcement of RICO").

[161] *Civil Action*, 68 Notre Dame L. Rev. at 272-73. Cumulative remedies enhance remedial purposes. *Herman & McLean v. Huddleston*, 459 U.S. 375, 386 (1983).

[162] *See generally* Chayes, *Foreword: Public Law Litigation and The Burger Court*, 96 Harv. L. Rev. 4-5 (1982) (classic model of private dispute resolution contrasted with contemporary model of public grievances against aggregates of power); *Id.* at 8-26 (inappropriate private law standing limitations analyzed); Chayes, *The Role of the Judge in Public Law Litigation*, 89 Harv. L. Rev. 1281 (1976).

The purpose of the two statutes, taken together, is to prohibit schemes to defraud that utilize, in varying circumstances, the mails or interstate wire communications.[163] The statutes say nothing about "purchasers or sellers."

Only two elements need come together: a scheme to defraud and the use of the mails or interstate wires to execute it.[164] A "scheme to defraud" is not limited to common law concepts of fraud.[165]

Conceptual difficulties may arise, however, when parties or courts "confus[e] mail fraud with common law fraud,"[166] since (1) neither "purchaser or seller" standing limitations, (2) materiality or justifiable and detrimental reliance, nor (3) misrepresentation or omission are elements that circumscribe the substantive definition of a "scheme to defraud" in the mail and wire fraud statutes

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[163] *Parr v. United States*, 363 U.S. 370, 389 (1960); *United States v. Bohonus*, 628 F.2d 1167, 1171 n.7 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980) (mail and wire fraud read together).

[164] *Pereira v. United States*, 347 U.S. 1, 8-9 (1954); *Sun Sav. & Loan Ass'n v. Dierdorff*, 825 F.2d 187, 195 (9th Cir. 1987).

[165] *Durland v. United States*, 161 U.S. 306, 314 (1896). *See generally Bohonus*, 628 F.2d at 1171 ("non-technical standard") (citing *United States v. Louderman*, 576 F.2d 1383, 1389 (9th Cir. 1978), *cert. denied*, 439 U.S. 896 (1978)); *Dennis v. United States*, 384 U.S. 855, 860-861 (1966); *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924); *Haas v. Henkel*, 216 U.S. 462, 478-480 (1910); *Equitable Relief*, 62 Notre Dame L. Rev. at 587-588 n.237; Rakoff, *The Federal Mail Fraud Statute*, 18 Duq. L. Rev. 771 (1980) (general treatment of development of mail fraud).

[166] *Armco Indus. Credit Corp v. SLT Warehouse Co.*, 782 F.2d 475, 481 (5th Cir. 1986).

incorporated into RICO.[167] Accordingly, neither mail nor wire fraud's concepts of "scheme to defraud" under RICO are limited by "purchaser or seller" standing or similar common law requirements. As such, the District Court's summary judgment cannot be legally justified.

2. The District Court Misread And Misapplied Standing Under RICO.

Standing under RICO is granted to "[a]ny person injured in his business or property by reason of *a violation of Section 1962.*"[168] Thus, a RICO plaintiff need not be injured by the predicate acts enumerated in Section 1961(1) to sue for a violation of Section 1962(a)-(d). Injury by any element of the violation, including an overt act under Section 1962(d), sufficies.

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[167] *Brandenburg v. Seidel*, 859 F.2d 1179, 1187 (4th Cir. 1988) (no detrimental reliance for mail or wire fraud); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1129 (5th Cir.), *reh'g denied*, 863 F.2d 882 (1988) (no materiality or reliance for mail or wire fraud); *Warner*, 828 F.2d at 1530 (no purchaser or seller standing limitations); *Armco Indus. Credit Corp.*, 782 F.2d at 481-82 (no justifiable or detrimental reliance for mail fraud); *McLendon v. Continental Group, Inc.*, 602 F. Supp. 1492, 1506-10 (D.N.J. 1985) (RICO scheme to defraud: noting inapplicability of misrepresentation or omission in "scheme to defraud"). *Cf. Wilcox v. First Interstate Bank of Oregon*, 815 F.2d 522, 531 n.7 (9th Cir. 1987) ("need not decide" if elements of common law fraud and RICO mail fraud identical; *Armco* noted); *United States v. Halbert*, 640 F.2d 1000, 1007-09 (9th Cir. 1981) (no misrepresentation required, but if alleged, materiality, but not reliance, necessary.)

[168] 18 U.S.C. § 1964(c) (emphasis added).

In *Sedima*, the United States Supreme Court squarely addressed the issue of whether injury solely caused by predicate acts is sufficient to give standing. The defendants contended that only injury caused by the entire violation was cognizable. The Court did not restrict standing under RICO to those injured only by predicate acts. On the contrary, the Court *expanded* standing for those suing under Section 1962(c) to *include* plaintiffs only injured by predicate acts, because "the essence of the violation is the commission of those acts in connection with the conduct of an enterprise."[169]

Footnote 15 of the majority opinion in *Sedima* expressly recognized that recovery for those "injured . . . by reason of a violation of Section 1962" also *includes* those injured by the completed RICO violation itself. The Court stated:

> "Any recoverable damages occurring by reason of a violation of § 1962(c) will flow from the commission of the predicate acts.[15] . . .
>
> "[15]Such damages include, but are not limited to, the sort of competitive injury for which the dissenters would allow recovery."[170]

Unfortunately, the District Court here did not issue a written opinion explaining its rationale concerning its decision. But, apparently, the District Court has misread the standing rule of *Sedima* to require injury caused *only* by the predicate act of fraud in the sale of securities,

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[169] *Sedima*, 473 U.S. at 497 & n.15.

[170] *Id.*

because the District Court ignored the overwhelming evidence of Holmes' participation in the Bunnington manipulation and the key role that Holmes' manipulation of Aero Systems played in it. Instead, the District Court focused *solely* on the Aero Systems manipulation, concluded it had ended, and because SIPC was not a "purchaser or seller" of Aero Systems, concluded that SIPC had no standing to bring suit. The substance of the District Court's holding is that the only predicate act about which SIPC can complain is a Rule 10b-5 violation and that only Rule 10b-5 violations (predicate acts) violate RICO. This holding completely ignores the clear dictate of Congress that persons injured "by reason of *a violation of Section 1962*"[171] may seek redress for their injuries. The District Court's interpretation of Section 1964(c) is not warranted, as a plain reading of the statute reveals; nor can such an artificial rule that standing is *only* granted to those injured by predicate acts withstand a careful review of *Sedima*.

That the plaintiffs have been injured as a result of a violation of Section 1962 is clearly shown and supported by Holmes' investment of proceeds from the sale of one manipulated security into another. Section 1962(a) makes it unlawful to obtain an interest in an enterprise by investing or using in it income derived from a pattern of racketeering.[172] SIPC alleged and presented genuine issues of material fact that Holmes violated Section

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[171] U.S.C. § 1964(c) (emphasis added).

[172] 18 U.S.C. § 1962(a).

1962(a), and that SIPC has standing to sue for that violation. Such genuine issues are supported by the uncontroverted fact that Holmes invested income derived from a pattern of racketeering activity, the manipulation of Aero Systems stock, into an enterprise, Bunnington Corporation.[173] This investment into the enterprise, perpetrated to further the Bunnington manipulation,[174] injured SIPC in its business when the broker-dealers failed. Thus, SIPC has standing by virtue of the violation of Section 1962(a) of RICO itself to recover damages resulting from this investment. These rights exist under Sections 1962(a) and 1964(c), *regardless* of whether SIPC has standing to sue as a "purchaser or seller" of securities under Section 10(b).

VI

CONCLUSION

For the foregoing reasons, SIPC and the Trustees must be allowed to try their cases against defendant Holmes.

DATED: August 1, 1989

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[173] C.R. 1310, pp. 45-49, ¶¶114-119.

[174] *Id.*

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STATEMENT OF RELATED CASES
(Circuit Rule 28-2.6)

The following cases are hereby identified as "related cases":

1. *Securities Investor Protection Corp., et al. v. Vigman, et al.*, 764 F.2d 1309 (9th Cir. 1985), Docket Nos. 84-6074 and 84-6311. This case has previously been heard in this Court and involves the same transactions and events.

2. *Securities Investor Protection Corp. v. Vigman, et al.*, 803 F.2d 1513 (9th Cir. 1986), Docket No. 85-5786. This case has previously been heard in this Court and involves the same transactions and events.

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STATE OF CALIFORNIA)
) ss.:
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On August 1, 1989, I served the within Plaintiffs-Appellants' Opening Brief in re: "Securities Investor Protection Corporation vs. Robert G. Holmes, Jr." in the United States Court of Appeals for the Ninth Circuit, Nos. 89-55094 and 89-55128, and Excerpt of Record thereto, on all parties interested in said action, by placing two true copies thereof enclosed in a sealed envelope, with postage thereon fully prepaid, in the United States Post Office mail box at Los Angeles, California, addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed on August 1, 1989, at Los Angeles, California.

/s/ Ce Ce Medina
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Nos. 89-55094 and 89-55128

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

vs.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

On Appeal From The United States District Court For The Central District Of California Honorable A. Wallace Tashima

PLAINTIFFS-APPELLANTS' SEPARATE OPENING BRIEF

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CERTIFICATION OF INTERESTED PARTIES
Case Nos.: 89-55094 and 89-55128
Certificate required by Circuit Rule 28-2.1

The undersigned counsel of record for plaintiffs and appellants Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation certify that the Securities Investors Protection Corporation, a named plaintiff in the district court action, and the following persons, all named defendants in the same action, have an interest in the outcome of this case.

Seymour Vigman
Aero Systems, Inc.
Aerosonic Corporation
Creditbank, Inc.
Dash Industries Inc.
Haberco, Inc.
Habers, Inc., Defined Benefit Pension Trust
Ibebafin, S.A.
Keops, S.A.
Magnetic Technologies Corporation
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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

vs.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

PLAINTIFFS-APPELLANTS' SEPARATE OPENING BRIEF

I.

PRELIMINARY STATEMENT

This is the Separate Brief of Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated, and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation (the "Trustees")[1]

[1] The appeals before this Court have been consolidated. The Trustees and SIPC were directed to file a joint brief. The Trustees were given leave to file a separate brief addressing the

(Continued on following page)

addressing issues unique to their appeal from the summary judgment entered by the District Court in favor of Defendant Robert G. Holmes, Jr. ("Holmes") on the issue of causation under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[2]

II.

STATEMENT OF ISSUES

1. Did the District Court misapply the law of causation for injury arising out of a scheme or conspiracy to violate the antifraud provisions of the federal securities laws?

2. Did the District Court err in granting Holmes' Motion for Summary Judgment for lack of "loss causation" where genuine issues of material fact were presented concerning (1) Holmes' participation in a large scale scheme to manipulate six target securities; (2) Holmes' conspiring with those persons he asserts caused the Trustees' injury; and (3) Holmes' aiding and abetting the manipulation of those target securities that he asserts caused the brokerage firms' collapse?

(Continued from previous page)

Trustees' injury occasioned by violations of the antifraud provision of the federal securities laws. The Trustees join in the Statement of Jurisdiction and Standard of Review set forth in the Joint Brief.

[2] Section 10(b), 15 U.S.C. § 78j(b) (West 1981) and Rule 10b-5, 17 C.F.R. § 240. 10b-5.

III.

STATEMENT OF THE CASE

A. Nature of the Case

In late July 1981 two securities brokerage firms, Joseph Sebag Incorporated ("Sebag") located in Los Angeles and First State Securities Corporation ("FSSC") in Miami, were placed into liquidation under the Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq.* ("SIPA"). Both brokerage firms were victimized by a large scale scheme involving the manipulation of six securities traded in the over the counter market.[3] Both brokerage firms were used as conduits through which millions of dollars of illegal stock transactions were conducted.

It became clear that the same methods were used by the same perpetrators at both brokerage firms with the deliberate intent to operate a complex and sophisticated stock manipulation scheme. The scheme and the artificially inflated stock prices that resulted led to the financial instability and eventual collapse of both Sebag and FSSC when the scheme finally failed in July 1981.

This stock manipulation scheme drove the two brokerage firms into liquidation under SIPA and caused damages to the estates of Sebag and FSSC for which the Trustees seek redress.

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[3] Holmes and his co-defendants manipulated the securities of Aero Systems, Inc., Aerosonics Corporation, Bunnington Corporation, Creditbank, Inc., Dash Industries, Inc., and Osrow Products Corporation (hereinafter the "Target Securities").

B. Holmes, His Participation in the Manipulative Scheme to Defraud, And His Association with Other Defendants.

Holmes was one of the key individuals who participated directly in the defendants' manipulation scheme. Holmes had several accounts at FSSC through which he participated in the scheme. Holmes was the controlling shareholder and CEO of Aero Systems, one of the companies whose stock was manipulated. Holmes had a long history of suspect business transactions with the other participants in the scheme.

In May 1981, Holmes had known Joseph A. Lugo, Jr. ("Lugo")[4] for over fifteen years.[5] They had been through good and bad times together as they participated in several stock sales, mergers and transfers of a family of related companies that had their genesis in Aero Systems.[6] Some of these financial manipulations led to criminal and civil penalties for Lugo, Seymour Vigman ("Vigman")[7] and other participants in the scheme.

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[4] Lugo is a defendant and was the chief financial officer of FSSC. Lugo was the man inside who controlled most of the market in the Target Securities and who assisted in manipulating the market at FSSC by creating fake activity, setting artificially high prices, and restricting the floating supply of the Target Securities. C.R. 1310 at 6-19. Lugo's default has been entered in this action. He was later convicted of a felony in matters relating to tax law violations, and was sentenced to prison. (*United States of America v. Lugo*, No. S 87-00946-01 LBS (S.D.N.Y. filed July 11, 1988.)

[5] C.R. 1317 at 9, 15-17.

[6] C.R. 1317 at 18-21.

[7] Vigman was another long-time business associate of both Holmes and Lugo. Vigman was the subject of several civil and

(Continued on following page)

In the months leading up to May 1981, Holmes acquired a large number of Bunnington shares in the public market. Holmes bought most of his Bunnington stock through his accounts at FSSC,[8] which were handled by Lugo, Holmes' friend and broker.[9] Holmes purchased large blocks of Bunnington stock from Lugo at FSSC which Holmes resold in sixty-six carefully timed transactions through other broker-dealers.[10] These transactions and Holmes' participation in the manipulation scheme are discussed in the Joint Brief at 29-37.

Through private placements directly with Bunnington, Holmes acquired large blocks of approximately 90,000 shares of Bunnington stock which were restricted. 40,000 of these shares were to be freed from restrictions and could be sold into the public market in September 1981.[11] Holmes purchased these shares between 1979 and 1981 at prices averaging under three dollars per share. By May 1981, as a result of the scheme and conspiracy, Bunnington stock was manipulated by the scheme up to prices between $11 and $12 per share.[12]

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criminal proceedings as a result of numerous stock manipulation schemes he engineered. Vigman is also a convicted felon. C.R. 1317 at 11, 16-17, 20, 29-37.

[8] C.R. 1296, Ex. 3863.

[9] C.R. 1317 at 15; C.R. 1310 at 38.

[10] C.R. 1310 at 37-40.

[11] In May, 1981 Holmes had a Bunnington debenture which could be converted into 40,000 shares of Bunnington stock. Holmes converted the debenture into the 40,000 shares of Bunnington stock in July, 1981. C.R. 1317 at 92.

[12] C.R. 1317 at 95-98; C.R. 1309 at 15-18.

In May 1981 Holmes knew that if the price of Bunnington stock could be maintained at the $11-12 price range for only three more months,[13] Holmes' investment in Bunnington would be worth almost five times what he paid for it. It was with this background that Lugo and Holmes entered into the stock parking[14] transactions on May 20 and 29, 1981.

As an integral part of the manipulative scheme and to maintain the artificially inflated price of the Target Securities, Holmes, Lugo and the other defendants had to control the public supply of the Target Securities. One of the techniques used by Lugo and his cohorts was to employ FSSC and Sebag as repositories for the excess public supply of the manipulated stocks. As a consequence, as of May 18, 1981, FSSC's inventory reached an all-time high of $688,378, more than one-third of which was Bunnington stock.[15]

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[13] C.R. 1310 at 37-38.

[14] *SEC v. First City Financial Corp.* 688 F. Supp. 705, 719-24 (D.D.C. 1988). (" . . . a parking arrangement – a concealment of stock ownership achieved by placing the stock in an account in the name of a third party." *Id.* at 720.). *Cf. Rubin v. Posner*, 701 F. Supp. 1041, 1049 (D. Del. 1988). "Stock Parking" transactions have become the source of an ever-widening series of regulatory and criminal proceedings initiated by the Securities and Exchange Commission ("SEC") and the Justice Department. *See In the Matter of the Application of Whiteside & Company Inc.*, Exchange Act Release No. 26187, 1988 SEC Lexis 2063, 1 (Oct. 14, 1988) aff'd No. 88-4921 (5th Cir., July 24, 1989). The recent convictions in the *Boesky, Bilzerian, Drexel,* and *Jeffries* cases have all involved stock parking transactions. *Business and the Law; Is 'Stock Parking' like Jay Walking?*, N.Y. Times, March 14, 1988, at 2, col. 1.

[15] C.R. 1317 at 100.

At this point, FSSC was in jeopardy of violating the "net capital requirements" promulgated by the SEC,[16] pursuant to the federal securities laws. FSSC was required to file monthly reports of its net capital position to the National Association of Securities Dealers, Inc. ("NASD").[17] FSSC's net capital report for May 1981 would include all trades through May 21, 1981. FSSC's excess inventory, and the consequent reduction of net capital caused by the increase in inventory,[18] would have threatened FSSC's ability to remain in business and continue the manipulating scheme.

Through a carefully timed and orchestrated series of maneuvers, Holmes and Lugo were able to conceal a substantial block of Bunnington stock from NASD regulators, making FSSC appear to comply with the SEC net capital requirements.[19]

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[16] *See* SEC rule 15c3-1, 17 C.F.R. 240.15c3-1.

[17] This monthly report is called a "Focus Report" which details the financial condition of the brokerage firm as of the date of filing. FSSC reported its net capital to the NASD on a monthly basis, using the last Friday settlement as the closing date for financial statement and net capital computation. Trades as of May 21st were to be settled on May 29th, allowing five business days and one extra day to allow for the Memorial Day holiday, pursuant to the NASD Uniform Practice Code Paragraph 3504, Section 4. C.R. 1317 at 100 n. 118.

[18] By placing FSSC inventory stocks in customer accounts, FSSC reduced its net capital requirements as imposed by SEC regulations. Inventory stocks, unlike customer account stocks, are discounted in value in order to assess net capital compliance. This discount is commonly referred to as a "haircut". C.R. 1310 at 20 n.7

[19] C.R. 1317 at 100-102.

On May 20, 1981, Lugo entered a purchase order for 5,000 shares of Bunnington stock from FSSC's inventory account to Holmes' account at FSSC at a price of $61,250.00.[20] Holmes should have paid for this sale by May 28, 1981.[21] He did not.[22]

On May 29, 1981 Holmes sold the 5,000 Bunnington shares back to FSSC. This transaction would normally settle on June 5, 1981. However, Lugo was able to arrange an accelerated settlement of this sale for June 1, 1981.[23] Lugo also arranged for a check to be hand delivered to Holmes four days earlier than normal. This prepayment permitted Holmes to cover the original purchase with funds derived from FSSC.[24] Accomplishing this feat required precise timing and coordination among Lugo and Holmes.

To make the payment on June 1, 1981, FSSC had to borrow funds from the Stock Clearing Corporation of Philadelphia ("SCCP"). An employee of FSSC, Robert Reber ("Reber"), delivered the check which Holmes immediately endorsed, and which Reber then delivered to Holmes' bank for deposit.[25] On the same day, Holmes' band wired $61,250.00 to SCCP to be credited to the FSSC

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[20] C.R. 1317 at 15, 100-101.
[21] C.R. 1310 at 25.
[22] C.R. 1310 at 26.
[23] C.R. 1310 at 26.
[24] C.R. 1317 at 101.
[25] C.R. 1317 at 102.

loan account for payment of the stock originally purchased on May 20, 1981.[26] Ordinarily, payment would be made by a draft sent to FSSC's own bank to be credited to its bank account.[27] Through this parking transaction, Holmes "paid" for the 5,000 Bunnington shares with FSSC's own funds.[28] This transaction is expressly forbidden by SEC Rule 15c3-1, and had the net effect of increasing FSSC's inventory of Bunnington stock by 5,000 shares at a value of $61,875.00.[29]

The May 20 and 29, 1981 transactions facilitated the continuation of the manipulative scheme through June and into July 1981.[30] As a direct result of these transactions and the continued manipulation of the Target Securities, FSSC's net capital position substantially worsened.[31] If FSSC has simply ceased operations in May 1981, its losses would have been limited to $779,594. Because FSSC continued in business to July 24, 1981, its losses increased to $2,634,976.[32] To stabilize the price of the Target Securities and perpetuate the manipulative scheme, Sebag was forced to purchase $7 million worth of manipulated stock from FSSC for Sebag's inventory

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[26] C.R. 1317 at 103.
[27] C.R. 1317 at 101.
[28] C.R. 1317 at 103.
[29] C.R. 1310 at 28.
[30] C.R. 1310 at 24.
[31] C.R. 1310 at 34-36.
[32] C.R. 1310 at 35-36.

account.[33] If FSSC had stopped trading in May 1981, Sebag would not have collapsed.[34]

IV.
ARGUMENT

A. The District Court Failed to Apply The Appropriate Standard of Causation Where A Scheme To Defraud, or Conspiracy or Aiding and Abetting to Violate The Securities Laws Exists.

1. The District Court's Ruling.

The District Court did not issue an opinion and the parties are left to infer from the record the reasoning behind the Court's ruling.

The District Court, at oral argument, announced its tentative ruling that Holmes' conduct was too attenuated from the losses sustained to afford recovery by the Trustees.[35] Based upon the Court's order and comments from the bench, the Court analyzed the causation issue solely upon the isolated conduct of Holmes and not upon

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[33] C.R. 1317 at 108.

[34] C.R. 1317 at 109.

[35] At the hearing on the motions the Court stated:

> But on [Holmes'] remaining claims, I think my inclination is to grant the motion. I don't know if I can express myself any further. I think the causation claims, it's not so much whether or not there is an issue of fact. It's a question of, I think, attenuation and how far out can you spin the web and still find causation. I think that's almost what it amounts to. R.T. at 9.

the conduct of Holmes as a participant in a scheme to defraud.[36]

Holmes was only one of many persons engaged in the scheme to manipulate the Target Securities.[37] Consequently, Holmes' liability should have rested, not upon an analysis of his conduct in isolation from the conduct of his cohorts in the scheme, but upon established principles of causation previously set forth by this Court.

2. Injury From A Scheme to Defraud Arises from All of The Interacting Elements of The Scheme to Violate The Securities Laws.

The District Court clearly erred by using a legal standard that is inappropriate for determining causation where a scheme to defraud is alleged.

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[36] The court was misdirected in this regard by the very method employed by Holmes in seeking summary judgment. Holmes carved out his conduct, and urged the District Court to judge his conduct in isolation, from the conduct of his co-schemers and co-conspirators. Holmes filed *three* separate motions, each supported by separate exhibits, statements of uncontroverted fact and law and memoranda of points and authorities. C.R. 1273-1281 and 1290. One motion was directed to causation (C.R. 1281), one to claims asserted under RICO (C.R. 1277), and a third to SIPC's standing under Section 10(b) (C.R. 1275, 1290). To further complicate the record, Holmes submitted at least four separate proposed Summary Judgment Orders and Statements of Uncontroverted Facts and Conclusions of Law (C.R. 1341, 1342, 1343 and 1344). The District Court's modifications of those proposed Orders, Findings and Conclusions of Law clearly reveal that the motions were analyzed and decided on the basis of the purported conduct of Holmes individually rather than as a participant in the scheme to defraud. (C.R. 1342, 1343.)

[37] C.R. 1317 at 1.

The District Courts within the Ninth Circuit, citing *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), have held that where a *scheme to defraud has been alleged*, proximate cause is proven from all the interacting elements of the scheme, not by the isolated conduct of an individual participant. See *In re Washington Public Power Supply System*, 650 F. Supp. 1346, 1355 (W.D. Wash. 1986) and *Kafton v. Baptist Park Nursing Center, Inc.*, 617 F.Supp. 349, 350-351 (D. Ariz. 1985). In *Kafton*, the court held:

> In a rule 10b-5 scheme to defraud cause of action a plaintiff's injury stems not solely from a particular misstatement or omission but *from all the interacting elements of the scheme*. . . . In that instance, the causal nexus is not between a particular misrepresentation and the plaintiffs, but between the entire functioning scheme and the injury.

Kafton, 617 F. Supp. 350-51. (emphasis added)

The District Court erred by failing to apply this standard where there existed a connection between the "entire functioning scheme," in which Holmes participated, and the Trustees' "injury". *Id.* Consequently, the District Court's Findings of Fact and Conclusions of Law[38] are insufficient to support summary judgment in favor of Holmes. There is no clear finding that Holmes was not part of a conspiracy or scheme to violate Section 10(b) or Rule 10b-5.[39]

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[38] C.R. 1342 at 2-10

[39] Such a finding could not be made on the state of the evidence before the District Court as acknowledged by the

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3. Injury From A Conspiracy to Defraud Is Judged from The Entire Conspiracy, Not Just From Its Parts.

The District Court erred when it judged Holmes' conduct in isolation from the conduct of his co-conspirators, and concluded that Holmes was not a proximate cause of the Trustees' injury. However, in a conspiracy, causation must be judged by the entire conspiracy, not merely its constituent parts. *Beltz Travel Service, Inc. v. Int'l Air Transport Ass'n*, 620 F.2d 1360, 1366 (9th Cir. 1980), citing *United States v. Patten*, 226 U.S. 525, 544 (1913); *see also American Tobacco Co. v. United States*, 147 F.2d 93, 106 (6th Cir. 1944), *aff'd*, 328 U.S. 781 (1946).

In *Beltz*, this Court observed as follows:

> The Complaint alleged that the appellees were a part of an overall conspiracy in which they knowingly and willfully participated. We therefore apply the well-established principle that *"a conspiracy [is] not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole."*

620 F.2d at 1366 (emphasis added) (citations omitted).

Section 10(b) and Rule 10b-5 reach conspiracies to defraud. *Ferguson v. Omnimedia, Inc.*, 469 F.2d 194, 197 (1st Cir. 1972).[40] *See also Dasho v. Susquehanna Corp.*, 380 F.2d

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court in its Order Granting Summary Judgment (RICO claims). C.R. 1343 at 2-3.

[40] Significantly, the First Circuit in *Ferguson* instructed that summary judgment is ordinarily inappropriate where a

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262, 267 n.2 (7th Cir.), *cert. denied sub nom. Bard v. Dasho*, 389 U.S. 977 (1967); *Hoffman v. Halden*, 268 F.2d 280, 295-96 (9th Cir. 1959) (overruled on other grounds in *Cohen v. Morris*, 300 F.2d 24 (9th Cir. 1962)), *Herpich v. Wilder*, 430 F.2d 818, 819 (5th Cir. 1970), *cert. denied*, 401 U.S. 947 (1971).

In *Ferguson*, the court reversed the grant of summary judgment and held that a co-conspirator may be held accountable for another co-conspirator's acts, committed in the furtherance of their conspiracy:

> If [defendant] took part in the conspiracy, she may be held responsible for the acts of a coconspirator that actually misled the appellant into buying stock (such as her husband's furnishing of a false balance sheet), even if she herself did not participate in those acts.

Ferguson, 469 F.2d at 197.

Here, the Trustees presented substantial evidence of Holmes' overt acts committed in furtherance of the manipulative scheme to defraud. The evidence was sufficient for the District Court to find that there was a genuine issue of material fact as to whether Holmes conspired to violate RICO. The District Court erred in

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conspiracy has been alleged, since "[i]n a conspiracy case, agreement is rarely out in the open, and proof of conscious complicity may depend upon the careful marshalling of circumstantial evidence and the opportunity to cross-examine hostile witnesses. As in the present case, summary judgment procedures are often not a sufficient substitute for trial." *Ferguson*, 469 F.2d at 198, citing, *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970).

considering the Trustees' claims against Holmes under Section 10(b) and Rule 10b-5 in a vacuum. It should have judged Holmes and his co-conspirators' actions together in determining the cause of the Trustees' harm. Accordingly, Holmes' summary judgment should be reversed, and this case should be remanded for trial.

4. The District Court Erred By Railing to Address Holmes' Liability for Aiding and Abetting The Manipulation of The Target Securities.

The District Court committed reversible error by granting Holmes' motion for summary judgment on the issue of causation when the Trustees submitted compelling evidence that was more than sufficient to create a genuine issue of material fact that Holmes aided and abetted the manipulation of Aero Systems and Bunnington stock.

The Ninth Circuit has repeatedly instructed that the elements of a claim for aiding and abetting under Section 10(b) and Rule 10b-5 consist of (1) the existence of an independent primary wrong, (2) actual knowledge by the alleged aider and abettor of the wrong and of his or her role in furthering it, and (3) substantial assistance in the wrong. *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 188 (9th Cir. 1987); *Harmsen v. Smith*, 693 F.2d 932, 943 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983); *SEC v. Rogers*, 790 F.2d 1450, 1460 (9th Cir. 1986).[41]

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[41] Secondary liability may attach even though the aider and abettor assisted in the scheme only by silence or inaction

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In the trial court, Holmes did not dispute that the Trustees presented substantial evidence of a primary wrong. In the first instance, Holmes conceded for purposes of his motion that Aero System stock was manipulated, and Holmes affirmatively argued that "the large concentration of artificially-inflated Bunnington and Aerosonic stock in FSSC's and Sebag's closing inventories was a substantial cause of the demise of the brokerage houses. . . . "[42]

The Trustees submitted overwhelming evidence of Holmes' knowing participation in the manipulation of Aero Systems stock[43] and Bunnington stock.[44] Holmes, using his concept of "sponsorship"[45], used public relations firms to disseminate false and misleading information[46], and used market makers to create investor interest in Aero Systems. Similarly, Holmes invested heavily in Bunnington stock, encouraged public relations firms and market makers to promote and market Bunnington stock,[47] and participated with Lugo in sham transactions to park unlawfully Bunnington stock in Holmes' account

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where a duty exists to disclose. *Strong v. France,* 474 F.2d 747, 752 (9th Cir. 1973). A duty to disclose arises from knowing of or assistance in a fraudulent scheme. *Id.*

[42] C.R. 1281 at 12-13.

[43] C.R. 1317 at 42-90.

[44] C.R. 1317 at 90-103.

[45] C.R. 1317 at 5-6.

[46] C.R. 1317 at 48-90; C.R. 1310 at 13-15.

[47] C.R. 1317 at 90-103.

at FSSC. These sham transactions created a false appearance of market activity, prevented a decline in the artificially inflated price of Bunnington stock,[48] and helped Lugo mask FSSC's net capital deficiency.

Holmes' transactions, including sales of Aero Systems stock to purchase Bunnington stock,[49] participation in the Bunnington stock manipulation,[50] and parking Bunnington stock in his account to aid Lugo in evading FSSC's net capital requirements,[51] constitute substantial assistance, sufficient to hold Holmes secondarily liable for all damages flowing from the manipulative scheme. *Rubin v. Posner,* 701 F.Supp. 1041, 1049 (D. Del. 1988) (secret agreement to park securities sufficient to constitute substantial assistance under Rule 10b-5 as well as loss causation). *See also SEC v. First City Financial Corp., Ltd.,* 688 F.Supp. 705 (D.D.C. 1988); *In Re Gas Reclamation, Inc. Securities Litigation,* 659 F.Supp. 493, 503 (S.D.N.Y. 1987).

5. The District Court Misapplied The Law of Causation And Its Ruling Is Contrary to Public Policy.

The District Court's ruling thwarts the remedial purposes of Section 10(b) and Rule 10b-5 by granting immunity to a participant in a series of fraudulent schemes that employed "novel" and "atypical" forms of fraud. The

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[48] C.R. 1309 at 15; C.R. 1310 at 23-29.

[49] C.R. 1310 at 44-45.

[50] C.R. 1317 at 90-99.

[51] C.R. 1310 at 25-29.

District Court's holding is contrary to the public policy behind the securities laws that "prohibit *all* fraudulent schemes . . . whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception." *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (emphasis in original).

The Trustees presented substantial uncontroverted evidence in the trial court that demonstrates Holmes' pivotal role in the scheme to defraud, his acts in furtherance of the manipulative conspiracy, and his aiding and abetting the manipulation of the Target Securities.

B. The Trustees Presented Substantial Evidence to Create Triable Issues of Material Fact that Holmes' Conduct in The Securities Law Violations Caused Their Injury.

Holmes argued in the District Court that even assuming that he had engaged in all of the securities law violations alleged by the Trustees, there was no genuine issue to be resolved concerning whether these violations caused losses to the brokerage firms.[52] Holmes asserted that neither the manipulation of the prices of the Target Securities nor the stock parking transactions caused any damages to FSSC or Sebag.

The Trustees submit that Holmes' participation in the manipulation of Aero Systems and Bunnington stock, the stock parking transactions that concealed FSSC's net capital violations – permitting FSSC to continue the manipulative scheme –, and his aiding and abetting securities

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[52] C.R. 1326 at 10.

law violations clearly demonstrate Holmes' activities in the manipulative scheme and conspiracy to defraud which proximately caused the Trustees' injuries. Because the Trustees presented substantial uncontroverted evidence of the causal link between the scheme to defraud, the conspiracy, assistance in violation of the federal securities laws and the Trustees' injuries, the trial court's decision should be reversed, and this case should be remanded for trial.

1. Holmes' Participation in The Parking Transactions Demonstrates His Responsibility for The Manipulative Scheme.

As set forth above, Holmes' participation in the parking transactions of May 20 and 29, 1981 establish that Holmes was an active participant in the broader fraudulent scheme involving Bunnington stock, among others. These transactions are analogous to the stock parking transactions presented in: *In the Matter of the Application of Whiteside & Company Inc.*, Exchange Act Release No. 26187, 1988 SEC Lexis 2063.1 (Oct. 14, 1988) *aff'd* No. 88-4921 (5th Cir., July 24, 1989).

In *Whiteside*, the SEC affirmed sanctions against the brokerage firm for engaging in stock parking transactions. The SEC condemned what it terms serious violations of the net capital reporting requirements, which were established for the protection of public investors. *Whiteside*, 1988 SEC Lexis 2063, at 11.

The participants in *Whiteside* used a scheme, similar to that used by Holmes and Lugo at FSSC, which

involved the transfer of positions from the firm's inventory account to the individual account of one of the firm's officers. The positions were parked off the books of the firm until the required report was filed. Then the positions were transferred back to the firm. The SEC had little difficulty dissecting these contrived transactions involving same day settlements, labeling them as "a sham," "false and misleading," and designed solely to "circumvent net capital requirements." *Id.* at 8.

The stock parking transactions engaged in by Holmes and Lugo bear all of the markings of the sham transactions condemned by the SEC in *Whiteside*. The questions and inferences concerning Holmes' participation in the overall manipulation, including the stock parking transactions, involved issues of material facts which should not have been decided by the District Court on a motion for summary judgment.

2. Holmes' Participation in The Bunnington and Aero Systems Manipulations Demonstrates His Responsibility for The Trustees' Injuries.

Holmes conceded for purposes of his Motion for Summary Judgment that Aero Systems stock was manipulated. Furthermore, Holmes affirmatively argued that "a large concentration of artificially-inflated Bunnington and Aerosonic stock in FSSC's and Sebag's closing inventories was a substantial cause of the demise of the brokerage houses. . . . "[53]

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[53] C.R. 1281 at 12-13.

The Trustees submitted substantial evidence that Holmes invested heavily in Bunnington stock, encouraged public relations firms and market makers to promote and market Bunnington stock, in addition to the transactions with Lugo to park Bunnington stock in Holmes' account at FSSC.

The net effect of these fraudulent activities was to create a false appearance of market activity in Aero Systems and Bunnington stock, maintain the artificially inflated prices of these and other stocks, and further the manipulative scheme.

Holmes' conduct was directly responsible for the damages to the estates of FSSC and Sebag and evidences Holmes' participation in the greater scheme to defraud.

3. The Existence of Genuine Issues Of Material Fact Should Have Precluded The Granting Of Holmes' Summary Judgment Motion

The manipulative scheme involved here is novel and complex. The net capital rule violations and the stock parking transactions which concealed these violations are key to understanding why Holmes' activities implicate him in this manipulative scheme and entitle the Trustees to recover damages against Holmes.

The Trustees should have been allowed to submit the evidence implicating Holmes in the stock manipulation scheme and conspiracy and stock parking transactions to a trier of fact. The Trustees should have been "given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each." *City of Long Beach v.*

Standard Oil Co. of California, 872 F.2d 1401, 1404-1405 (9th Cir. 1989), citing *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699 (1962).

V.
CONCLUSION

The Trustees submit that the District Court erred and the order granting summary judgment to Holmes should be reversed and this matter remanded for trial.

STATEMENT OF RELATED CASES

Plaintiffs and appellants Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation are aware of the following cases pending in the Ninth Circuit Court of Appeals which could be deemed related under Circuit rule 28-2.6:

Securities Investor Protection Corp., et al., vs. Vigman, et al., Nos. 84-6074, 84-6311, 764 F.2d 1309 (1985).

Securities Investor Protection Corp., et al., vs. Vigman, et al., No. 85-5786, 803 F.2d 1513 (1986).

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA)
) ss.:
COUNTY OF LOS ANGELES)

I am a citizen of the United States and a resident of or employed in the City of Los Angeles, County of Los

Angeles; I am over the age of 18 years and not a party to the within action; my business address is 1706 Maple Avenue, Los Angeles, California 90015.

On August 1, 1989, I served the within Plaintiffs-Appellant's Separate Opening Brief in Securities Investor Protection Corporation, et al vs. Robert G. Holmes, Jr., on all parties interested in said action, by placing two true copies thereof enclosed in a sealed envelope, with postage thereon fully prepaid, in the United States Post Office mail box at Los Angeles, California, addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct.

Executed on August 1, 1989, at Los Angeles, California.

/s/ Ce Ce Medina
CE CE MEDINA

Nos. 89-55094 and 89-55128

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

Plaintiffs-Appellants,

VS.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

On Appeal From The United States District Court For The Central District Of California Honorable A. Wallace Tashima

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SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL, TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG INCORPORATED, AND LAURENCE A. SCHROEDER, SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION,

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VS.

ROBERT G. HOLMES, JR.,

Defendant-Appellee.

On Appeal From The United States District Court For The Central District Of California Honorable A. Wallace Tashima

PLAINTIFFS-APPELLANTS' REPLY BRIEF

Plaintiffs-Appellants Securities Investor Protection Corporation ("SIPC") and Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated, and Lawrence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation (the "Trustees") (collectively "Plaintiffs") submit the following Reply Brief on

appeal from the summary judgment entered in favor of Defendant-Appellee Robert G. Holmes, Jr. ("Holmes").[1]

I.

INTRODUCTION

Rather than directly address the issues squarely presented in Plaintiff's Opening Briefs. Holmes wholly disregards the controlling legal principle that a conspirator is liable for the acts of his co-conspirators. By admitting that Lugo and others caused the injuries to SIPC and the Trustees, Holmes effectively concedes that he also is liable for the injuries. Of equal significance, Holmes makes only passing reference to the central legal issue presented on appeal, *viz.*, whether there is a "purchaser-seller" standing requirement under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

In seventy-five pages of factual minutiae, Holmes has dismembered the conspiracy, severed all illicit ties with his co-conspirators, twisted and distorted Plaintiffs' contentions and proffered implausible inferences of independent, rational and lawful conduct by Holmes. In the wealth of minutiae, the danger is run that the crucial questions in this appeal, legal and factual, may be forgotten.

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[1] As the non-moving parties, Plaintiffs are entitled to all permissible inferences and any doubts must be resolved in their favor. Plaintiffs-Appellants' Opening Brief ("Joint Brief") at pp. 7-9 and Plaintiffs-Appellants' Separate Opening Brief ("Trustees' Brief") (collectively "Opening Briefs").

The most telling omission in Holmes' brief, however, is his failure to deal with the hornbook law applicable to "conspiracy" and "scheme to defraud". The Amicus Curiae Brief of the Securities and Exchange Commission ("SEC") establishes beyond serious question that the principles applicable to "scheme to defraud" (at least where multiple parties are involved) are identical to those applicable to "conspiracy."[2] Vicarious liability attaches to those, like Holmes, who conspire to break the law and undertake an over act in furtherance thereof, provided the conspiracy causes harm to the plaintiff.

Holmes would have this Court believe that despite the District Court's finding that he participated in a RICO conspiracy, and despite the ample evidentiary record supporting that finding, Holmes did not participate in a conspiracy to manipulate securities other than Aero Systems. To prevail on the causation issue raised on appeal, however, Plaintiffs need only show that they have raised a single genuine issue of material fact as to whether Holmes participated in a conspiracy that caused injury to Plaintiffs. The evidence of Holmes' participation in such a conspiracy is, quite literally, massive.

Without a single reference to RICO, or any Supreme Court precedent construing the statute, Holmes argues that the "purchaser-seller" limitation on Rule 10b-5 should be imposed on the express right of action for a

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[2] Holmes passes off the Amicus Curiae Brief of the SEC as "irrelevant." (Opposition Brief, p. 50.) The SEC, however, is "the agency primarily responsible for the administration and enforcement of the federal securities laws. . . . " (Amicus Curiae Brief, p. 3.)

RICO violation predicated upon securities fraud. To the contrary, the text, structure, and legislative history – as well as the better judicial authority – demonstrate that RICO's remedial purpose cannot be so limited. Further, SIPC has standing to pursue RICO claims predicated on mail fraud and wire fraud, offenses which clearly are not subject to the "purchaser-seller" limitation.

Similarly, Holmes rejects Plaintiffs' position that proximate causation under the securities statutes and RICO are different, but offers no reasons to support his criticism. Plaintiffs' careful distinction between the language, policies and judicial construction of the two statutes stands virtually unchallenged on its merits.

Finally, Holmes' evidentiary objections, some of them made for the first time on this appeal, are without merit. The evidence and the record made before the District Court is admissible and more than sufficient to warrant a trial by jury.

The Order of Summary Judgment must therefore be reversed and this case remanded for trial.

II.

SIPC HAS STANDING UNDER RICO TO PURSUE THIS ACTION[3]

Holmes asserts that the judicially imposed purchaser-seller limitation applicable to the implied right of action

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[3] While SIPC's damages accrue as a result of a failure of Sebag and FSSC, those of the Trustees differ from those of

(Continued on following page)

under Rule 10b-5 applies with equal force to the express right of action under RICO. Holmes relies only on the Fourth Circuit's opinion in *International Data Bank v. Zepkin*[4] to support his argument, but never informs the Court that *Zepkin* did not include a claim based on the mail fraud statute.[5] The omission is significant, obviously, because SIPC presented evidence to the district court that Holmes committed acts of mail fraud and wire fraud.[6]

Holmes criticizes the Eleventh Circuit's opinion in *Warner v. Alexander Grant & Co.*,[7] as "without analysis or discussion,"[8] but offers none himself. Holmes completely fails to address Plaintiffs' extensive analyses of RICO offered to demonstrate the fundamental soundness of their position. Of critical important, Congress has not limited the express right of action granted by Section 1964(c) to those who have purchased or sold securities. Moreover, the predicate act of mail fraud contains no requirement that RICO plaintiffs buy or sell securities.

(Continued from previous page)

SIPC. In addition, standing to present these claims by the Trustees is not challenged by Holmes and is not an issue before the Court. The Trustees represent the estates of the debtors and have standing to recover, *inter alia*, damages the estates sustained as a result of trading in the manipulated securities prior to the liquidation of FSSC and Sebag. The District Court failed to recognize this distinction between SIPC and the Trustees.

[4] 812 F.2d 149 (4th Cir. 1987).

[5] *Zepkin* involved "only a Rule 10b-5 claim." Standing under other provisions of RICO was "not decid[ed]." *Id.* at 151.

[6] C.R. 1317, pp. 58-90.

[7] 828 F.2d 1528 (11th Cir. 1987).

[8] Opposition Brief, p. 68.

The Supreme Court has repeatedly held RICO's express text and legislative history, not its silence in the text or history, must guide RICO's interpretation.[9] The legislative history and the Supreme Court's mandate that RICO " 'be liberally construed to effectuate its remedial purposes' "[10] require that SIPC be allowed to bring this action, regardless of its status as a purchaser or seller of securities. Reversal of the order of summary judgment and a remand of this case is therefore appropriate.

III.

THE DISTRICT COURT ERRED BY GRANTING SUMMARY JUDGMENT BECAUSE THE EVIDENCE DEMONSTRATES THAT HOLMES ACTED IN FURTHERANCE OF A BROAD CONSPIRACY TO MANIPULATE TARGET SECURITIES AND VIOLATE THE SECURITIES LAWS AND RICO

Holmes attempts to limit his involvement in the conspiracy only to the Aero Systems manipulation[11], to sever all illicit ties with Lugo, Vigman and others, and to explain away his conduct as the product of rational, legitimate business dealings. His rationalizations and inferences simply do not ring true. As hard as he may try, Holmes cannot explain away the evidence presented to

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[9] *H.J. Inc. v. Northwestern Bell Telephone Co.*, 109 S.Ct. 2893 (1989); *United States v. Monsanto*, 109 S.Ct. 2657 (1989); *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495 n.13 (1985).

[10] *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 498 (1985), *quoting* Pub.L. 91-452, § 904(a), 84 Stat. 947.

[11] Holmes conceded for purposes of this motion that he participated in the manipulation of Aero Systems securities. C.R. 1281, p. 11. *See also* Joint Brief, p. 35, n.123.

the District Court by SIPC and the Trustees linking Holmes to the conspiracy and scheme to manipulate target securities.

A. The Evidence Demonstrates That A Common Goal, Manipulation Of The Target Securities Aero Systems And Bunnington, Was Motivated By The Greed Of Co-Conspirators Holmes, Vigman And Lugo.

Holmes, Vigman and Lugo had a common interest and goal to manipulate the prices of the target securities Aero Systems and Bunnington. The motive for this goal was greed. This common interest, and the acts they took in relation to each of these stocks, compels the inference of a carefully calculated conspiracy to manipulate the prices of both securities.

Holmes' interest in artificially inflating Aero Systems' prices flowed from his position with the company as president and its principal shareholder, holding 1,317,320 shares with a market value of over $7 million[12] in the spring of 1981. Indeed, he profited handsomely from the manipulation: between 1978 and 1981 Holmes sold 154,000 shares of Aero Systems, generating proceeds of $704,000.[13] Vigman, of course, also held large blocks of Aero Systems stock which he had obtained through Holmes' largess – the earlier exchange of worthless DCS stock for (eventually) tradable Aero Systems stock[14]

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[12] C.R. 1297, Exh. 5268; C.R. 1310, Exh. "E".

[13] C.R. 1310, p. 44, ¶ 111.

[14] C.R. 1317, pp. 33-36; Exhs. 5315 and 5316.

which Vigman partially sold for over $1.1 million in April and May, 1981.[15] Finally, Lugo made substantial trading profits through the manipulations and, indeed, reaped $863,000 in compensation from trading in the manipulated stocks from 1979 through the first four months of 1981.[16]

Identical interests motivated the three conspirators regarding Bunnington. Holmes had a substantial financial interest in keeping Bunnington's stock prices artificially high. In September of 1979, Holmes purchased a $100,000 convertible debenture which he converted into 40,000 shares of Bunnington in July 1981.[17] The restriction in sale of these shares was to be lifted in September 1981, only two months after the demise of FSSC and Sebag. Further, Holmes had also paid $150,000 to acquire an additional 50,000 shares of Bunnington (at $3 per share).[18] The "market" price of Bunnington in May 1981 was between $11 and $12 per share.[19] Thus, Holmes' 90,000 shares of Bunnington had a "market" value in excess of $1 million. Vigman was the largest shareholder of Bunnington, having a personal fortune tied up in 397,650 shares of Bunnington valued in excess of $4 million at the artificially inflated prices in effect shortly before the collapse.[20] Lugo also had a compelling interest in the common goal; there

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[15] C.R. 1310, p. 18, ¶ 26.

[16] C.R. 1310, p. 23, ¶ 41.

[17] C.R. 1317, p. 92.

[18] C.R. 1310, p. 45, ¶ 113.

[19] C.R. 1310, p. 54, ¶ 136.

[20] C.R. 1310, p. 54, ¶ 136; C.R. 1317, Exh. 6625.

was considerable sell pressure on Bunnington at the critical time.[21] and he had to maintain the artificially high price or FSSC would realize substantial losses in its trading account (which eventually occurred).[22]

Thus, each of the conspirators had compelling financial motives to manipulate the prices of both Aero Systems and Bunnington stocks[23].

When Lugo needed help to maintain the artificial price of Bunnington, he turned to Holmes and Vigman; when Lugo needed financing to buy Bunnington (and Aerosonic) in April, he turned to Vigman; when Lugo needed a trusted customer to assist in maintaining an artificial price for Bunnington, he turned to Holmes for market activity and parking; when Vigman and Lugo needed to maintain Bunnington's artificial price, they turned to Holmes to create market demand for Bunnington, tout Universal Silicon, and to pledge Aero

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[21] C.R. 1310, p. 19, ¶ 31.

[22] C.R. 1310, p. 36, ¶ 88.

[23] The fact of the conspiracy does not rest on financial motives alone. The conspiracy must be viewed in the historical relationship among the conspirators. Holmes owed much to Vigman; Vigman was described in 1980, as Holmes' "financial consultant, best friend and director" (C.R. 1317, pp. 1848-50), "confident" (*Id.*, p. 1852), and an "advisor" (*Id.*, p. 1761). Vigman claims that he was never paid for his advice to Holmes (*Id.* p. 2048). Holmes' substantial assistance in efforts to keep the price of Bunnington stock artificially high (see Section III.C. below and Joint Brief, pp. 29-34) were Holmes' "pay off" to Vigman and Vigman's brother-in-law, Diamond, who was a major shareholder and Chairman of Bunnington. Joint Brief, p. 30 n. 96.

Systems' stock to secure a $600,000 loan to buy Bunnington.[24] Thus, the three co-conspirators accomplished their common objectives together.

B. The Bunnington "Park" Is Direct Evidence Of Holmes' Complicity In The Broader Conspiracy To Manipulate The Target Securities.

In a revisionist attempt to legitimize his Bunnington parking transaction, Holmes argues for the first time on appeal that his May 29, 1981 sale of 5000 shares of Bunnington relates to his May 5, 1981 purchase of Bunnington shares, rather than his May 20, 1981 purchase.[25] Holmes' improvised argument that the applicable stock certificate numbers prove that he delivered the May 5, 1981 shares on June 1, 1981 to FSSC to cover the May 29, 1981 sale is illusory and meaningless.[26]

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[24] See Sections III.B.-F. below and Joint Brief, pp. 29-37.

[25] Opposition Brief, pp. 35-36.

[26] In his Opposition Brief, Holmes improperly purports to augment the record by identifying new evidence, to wit, the actual certificate numbers. (*Id.*, p. 36.) Holmes' attempt to introduce new evidence or argue new factual matters on appeal is barred by operation of law. *See Nissho-Iwai Am. Corp. v. Kline*, 845 F.2d 1300, 1307 (5th Cir. 1988); *Harkins Amusement Ent. v. Gen'l Cinema Corp.*, 850 F.2d 477, 482 (9th Cir. 1988), *cert. denied sub nom, United Artists Theater Circuit, Inc. v. Harkins Amusement Ent.*, 109 S.Ct. 817 (1989). Curiously, Holmes does not present any support for the new "evidence" to the Court. The certificate numbers are not, as Holmes suggests, available in the FSSC books and records. In any event, the certificate numbers are irrelevant.

It is wholly immaterial which certificate numbers were delivered by Holmes for his May 29, 1981 sale.[27] Lugo and Holmes "parked" Bunnington stock by arranging to prepay Holmes' May 29, 1981 sale and provide Holmes with the funds to cover his May 20, 1981 purchase in violation of Federal Reserve Board regulations.[28]

Holmes claims, nevertheless, that his May, 1981 trading in Bunnington shares was "in conformity with" legitimate trading activity.[29] The evidence establishes just the opposite. First, Holmes received an improper prepayment from his May 29, 1981 sale in order to pay for the May 20, 1981 purchase of Bunnington stock.[30] Second, an employee of FSSC hand-delivered the check representing the sale proceeds to Holmes for endorsement and deposit the same day.[31] Third, the sale was entirely inconsistent

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[27] C.R. 1310, p. 27, ¶ 58.

[28] Regulation "T" of the Federal Reserve Board requires payment by the customer before proceeds of the sale are released to the customer. 12 C.F.R. § 220.8 (1989).

[29] Opposition Brief. p. 40.

[30] The May 29, 1981 Holmes sale of 5,000 Bunnington shares "settled" on June 5, 1981, yet Holmes received a check for $61,875 from FSSC on June 1, 1981, four days earlier. Holmes' May 20, 1981 purchase of 5,000 Bunnington shares "settled" on May 28, 1981. Holmes claims he did not pay for these shares, however, until June 2, 1981. This was three business days after settlement of his May 20, 1981 purchase and one day after FSSC prepaid him for the sale. C.R. 1310, pp. 25-29. ¶¶ 48-63. This is not "in conformity with" ordinary customer transactions.

[31] C.R. 1310, p. 29, ¶ 63.

with Holmes' trading pattern in Bunnington stock.[32] Fourth, FSSC borrowed $125,000 to ensure the check to Holmes did not bounce.[33] Fifth, Holmes had significant motives to assist Lugo in concealing FSSC's deficiency – to protect the value of his own Bunnington holdings and perpetuate the broader conspiracy to manipulate target securities. Finally, the only expert to testify on the issue, Plaintiffs' expert James C. Foley, concluded that the transaction constituted parking of securities.[34]

In sum, it is Holmes, not SIPC and the Trustees, who ignores all meaningful evidence of the involvement and coordination needed between Lugo and Holmes to carry out the Bunnington park. The Bunnington park did not happen by chance, nor by Lugo's unilateral conduct. It was prearranged and planned. In substance, Holmes paid for the Bunnington shares involved in the parking transaction with FSSC funds.

As a result, Plaintiffs have no doubt, and there is at least a genuine issue of fact, that Holmes was a knowing participant in the greater conspiracy to defraud. Plaintiffs have come forward with "specific facts showing that

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[32] Holmes sold 53,900 shares of Bunnington stock on 64 different trades through various brokers between March 2, 1979 and June 16, 1981. His only "sale" at FSSC during this period was the 5,000 shares sold on May 29, 1981, the sale returning the parked shares to Lugo. C.R. 1310, p. 29, ¶ 63. (Holmes claims that Plaintiffs have misled the Court by failing to state that Holmes' 66 trades in Bunnington spanned a four year time frame (Opposition Brief, p. 32), yet 64 of the 66 trades occurred in just over two years.)

[33] C.R. 1310, p. 26, ¶ 54.

[34] C.R. 1310, pp. 27-28, ¶¶ 56-62.

there is a genuine issue for trial."[35] It was error for the District Court to grant summary judgment, because "the drawing of legitimate inferences from facts are jury questions, not those of a judge. . . . The evidence of [Plaintiffs] is to be believed and all justifiable inferences are to be drawn in [Plaintiffs'] favor."[36]

C. Holmes Conspired With Lugo In Creating Demand Volume For Bunnington In Furtherance Of The Bunnington Manipulation.

Based only on attorney conjecture, and without any support from expert testimony, Holmes contends that he could not have "constricted the floating supply" of Bunnington stock because he had more sales than purchases in 1981, and that these sales represented less than 1% of the total trading volume of 2.6 million shares in the over-the-counter market.[37] Holmes' unsupported analysis of the Bunnington manipulation misses the point.[38]

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[35] *Matsushita Elec. Indus. Co. v. Zenith Radio,*, 475 U.S. 574, 587 (1986).

[36] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986).

[37] Opposition Brief, pp. 31-33. Holmes presented no expert testimony on causation issues other than the testimony of Plaintiffs' experts. As a result, there is no evidence that contradicts or rebuts the opinions of expert witnesses Foley and Torkelson. Holmes' citation to Plaintiffs' experts is out of context and of no moment.

[38] SIPC and the Trustees do not contend that Holmes and Lugo were solely responsible for the Bunnington manipulation. Other participants included, *inter alia*, defendants Garrity, Vigman, Diamond and McNeil.

On nine separate occasions between May 31, 1979 and May 20, 1981 Holmes' purchases of Bunnington represented 51% of NASDAQ average daily volume.[39] On these occasions Holmes conspired with Lugo in creating demand volume, thus stimulating interest in Bunnington to the investing public during periods of low trading.[40]

In the nine purchase transactions with FSSC, Holmes played a dominant role and assisted Lugo in controlling the market on the days that he traded.[41] Further, the evidence is clear that Holmes traded on inside information,[42] received preferential treatment from Lugo and

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[39] C.R. 1310, p. 40, ¶ 98.

[40] Lugo, as the primary market maker of Bunnington, relied on Holmes and other select customers to purchase the stock, on a given day or at a given time, in order to maintain artificially the market price. Holmes' effort to hide in the larger group of Bunnington purchasers is a ludicrous attempt to mask his participation in the manipulation of Bunnington's price. Opposition Brief, p. 34. Unlike normal investors, Holmes and his co-conspirators traded Bunnington with the intent and effect of manipulating the market price. C.R. 1310, pp. 40-41. ¶¶ 99, 102.

[41] C.R. 1310, p. 40, ¶ 99. Holmes assisted Lugo in soaking up the floating supply of Bunnington stock up purchasing Bunnington from FSSC. *Id.*

[42] Holmes claims that he did not trade on inside information when he bought Bunnington shares on May 5, 1981, one day prior to Bunnington's falsely optimistic announcement that it was acquiring Universal Silicon. Opposition Brief, pp. 48-49. As in numerous other instances, Holmes argues that the timing of his purchase was purely fortuitous, yet Holmes himself wired the false press release to Moore Schley on May 6, 1981. This argument by Holmes, as all others he makes about

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sold Bunnington only in small lots through other brokers at virtually no profit.[43] These are indicia of participation in a market manipulation. Further, following the collapse of FSSC and Sebag, Holmes renewed his effort to assist co-conspirator Vigman in maintaining artificially the price of Bunnington.[44] It is for the jury to decide whether Holmes' trading was rational, economically motivated, or as SIPC and the Trustees contend, part of the greater conspiracy and scheme to defraud.

D. Plaintiffs' Damages Are Not Limited By The Initial Net Capital Deficiency At FSSC.

Holmes argues, repeatedly, that it is inconsistent and illogical to blame him for injuries to SIPC and the Trustees when several of the events causing the injuries

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what the facts mean, merely serves to emphasize the need to submit them to a jury for resolution.

[43] C.R. 1310, pp. 38-39, ¶¶ 94, 96-97.

[44] Notwithstanding Holmes' claim that he believed Bunnington was a stock with "merit" (Opposition Brief, p. 47), the evidence clearly indicates that his purchases were made to fill the demand void left by the demise of market makers FSSC and Sebag, as an accommodation to his co-conspirator Vigman, the largest shareholder in Bunnington. Holmes' extensive post-collapse Bunnington stock purchases made over time with $600,000 borrowed against his Aero Systems' stock (C.R. 1317, p. 98) is compelling evidence of a pre-collapse conspiracy between Holmes and his long-time friend, advisor and financial consultant, Vigman, to artificially maintain the value of Bunnington stock.

occurred after April 1981, the time when FSSC first experienced a "net capital deficiency."[45] It is Holmes' claims, however, that are syllogistic nonsense.

There is no reason why losses sustained by a brokerage firm in liquidation are limited by the events preceding the initial determination of a "net capital deficiency."[46] This is particularly significant where, as here, the initial determination of a "net capital deficiency" is concealed from regulators to allow the conspiracy to continue and associated losses escalate dramatically during the period of concealment and continued manipulation of target securities. Hence, it is pure sophistry to suggest, as does Holmes, that April 1981 was the date of injury or that subsequent events could not possibly have caused losses to SIPC and the Trustees.

A net capital deficiency is not a loss, as Holmes contends, but only a warning of potential loss.[47] Proper

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[45] Opposition Brief, pp. 26-28, 41-42. Holmes apparently confuses the March 1981 "reserve deficiency" at FSSC with an April 1981 "net capital deficiency," underscoring Holmes' misunderstanding of what a "net capital deficiency" represents and how it relates to the losses sustained by SIPC and the Trustees.

[46] Holmes has not cited any authority nor advanced any reason why losses would be limited or determined by events preceding a "net capital deficiency."

[47] See 17 C.F.R. § 240 15c3 (1988). Equally true, there is no merit to Holmes' contention that his role in impairing FSSC's net capital should be evaluated strictly as an $18,000 event. (Opposition Brief, pp. 41-42.) In his Opposition Brief, Holmes disingenuously attempts to single out the Bunnington "park"

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reporting of such deficiencies has the effect of giving a warning signal to regulators who will cause the brokerage firm to limit actual losses. Failure to make a proper report has the opposite effect. That is, brokerage firms, such as FSSC, who continue to operate while in a condition of net capital deficiency will sustain greater losses upon ultimate liquidation.

In the case of FSSC, its net capital deficiencies in 1981 resulted primarily from a massive accumulation, or "undue concentration," of the target securities, Bunnington and Aerosonic, in FSSC's trading account, an accumulation that began by April 1981. Had FSSC reported its true trading account positions, the regulatory process would have required a liquidation, or forced sale, of target securities in the trading account to achieve compliance with the net capital rule.[48] Such a forced sale, however, was undesirable to the conspiracy, because it would have flooded the market with shares of these securities, thereby depressing artificially high prices of

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as the only act of concealment of FSSC's "net capital deficiency." (*Id.*) It is abundantly clear that while Holmes was not solely responsible for the concealment, he facilitated FSSC and Sebag's ability to remain in business and expand their trading positions to "undue concentration" levels greatly in excess of their capitalization. SIPC and the Trustees, as a result, suffered total losses in excess of $30 million. This facilitation shows Holmes' complicity in the exponential accumulation of losses.

[48] If net capital is impaired by risks associated with large accumulations of inventory, regulators traditionally require an infusion of new capital or immediate liquidations of inventory at the market to achieve compliance with the net capital rule. C.R. 1310, p. 21, ¶ 36.

the target securities.[49] Instead, in furtherance of the conspiracy, Lugo falsified the FSSC net capital reports to deceive regulators and prevent the artificial market prices from decreasing.[50]

Thus, the concealment by Lugo, with Holmes' knowing and active assistance, allowed the conspiracy to continue manipulating target securities. During this period, these manipulations increased damages to SIPC and the Trustees to massive proportions.

E. Holmes' Admitted Manipulation Of Aero Systems Was Part Of The Larger Conspiracy To Manipulate The Target Securities.

Holmes portrays his admitted participation in the manipulation of Aero Systems stock in March and April 1981 as a purely fortuitous, coincidental event that has no connection whatsoever to the manipulations of Bunnington and Aerosonic.[51]

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[49] C.R. 1273, p. 101.

[50] The April-July 1981 concealment enabled Lugo to continue buying target stocks Bunnington and Aerosonic for FSSC's trading account in furtherance of the conspiracy. Total losses from the FSSC liquidation were approximately $4 million. C.R. 1342, p. 3. Sebag, by reason of its June-July 1981 purchases of manipulated target securities from FSSC for its trading account, experienced a massive net capital deficiency and losses of approximately $26.2 million. C.R. 1273, p. 139, Exh. 10,043. Had the "net capital deficiency" at FSSC been reported properly in April 1981, the losses incurred by FSSC and Sebag would have been substantially less than actually realized. C.R. 1310, p. 35, ¶ 83.

[51] Opposition Brief, pp. 18-50.

To support his position, Holmes separates, dissects, and mischaracterizes Plaintiffs' contentions.[52] Holmes also mischaracterizes the evidence by presenting individual facts out of context and in an environment that overlooks the underlying conspiracy.[53] He also ignores the effect of his admission that he participated in the manipulation of Aero Systems.

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[52] For example, Holmes contends Plaintiffs contradict themselves by contending that "profits" to FSSC caused "damages" to FSSC (Opposition Brief, p. 27), and by contending that a "capital infusion" can impair the net capital of a brokerage firm. *Id.*, pp. 30-31. To make his point, Holmes mischaracterizes Plaintiffs' contentions. Plaintiffs contend that Holmes and his co-conspirators successfully manipulated the price of Aero systems in 1981, as conceded by Holmes, then used the proceeds from sales of Aero Systems to underwrite the manipulations of target stocks Bunnington and Aerosonic. Plaintiffs further contend that when FSSC and Sebag could no longer conceal "net capital deficiencies" arising from "undue concentrations" in Bunnington and Aerosonic in July, 1981, regulators were forced to liquidate the brokerage firms. In effect, the "profits" or "capital" from the Aero Systems manipulation were reinvested into the RICO enterprise.

[53] Holmes contends it was Lugo's use of the proceeds from Vigman's sales of Aero Systems, not the source of funds, that give rise to Plaintiffs' damages. Opposition Brief, p. 30-31. Such a "source of funds" argument would only have significance if there was no evidence of a conspiracy to reinvest illicit proceeds or manipulate other target securities. However, there is abundant evidence of such a conspiracy and manipulation scheme. Moreover, Lugo's use of the funds made available by the Aero Systems manipulation to invest in the Bunnington manipulation would provide a direct benefit to Holmes, who traded in Bunnington and held a sizeable Bunnington convertible debenture. C.R. 1310, pp. 17-19, 38, ¶¶ 24-31, 92.

Holmes' arguments, however, only emphasize that there are disputed issues of material fact, entitling the Plaintiffs to present their claims to a trier of fact. The evidence of Holmes' participation in the Aero Systems manipulation demonstrates Holmes' participation in the conspiracy with Lugo, Vigman and others.

First, the *modus operandi* of the Aero Systems manipulation is similar to that used in the Bunnington manipulation.

(a) False press releases were published by Aero Systems and Bunnington;[54]

(b) Holmes solicited Moore Schley to take an interest in Aero Systems and Bunnington in order to support the prices of the respective stocks;[55]

(c) Lugo dominated and controlled the market in both securities;[56] and

(d) The capital of FSSC was put at risk to underwrite the Aero Systems and Bunnington manipulations.[57]

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[54] C.R. 1317, pp. 58-88, 95-97. Holmes erroneously claims that there is no evidence that the Bunnington press release he sent to Moore Schley was false. Opposition Brief, p. 46. Like the Aero Systems press releases, the May 6, 1981 Bunnington press release falsely "hyped" Bunnington in connection with its announced acquisition of Universal Silicon. See C.R. 1309, p. 17, ¶ 21.

[55] C.R. 1317, pp. 72, 95.

[56] C.R. 1310, pp. 40, 50, ¶¶ 99, 124.

[57] C.R. 1317, pp. 105-108.

Second, the evidence shows that the Aero Systems manipulation was used to generate cash used by the conspiracy to finance the manipulation of Bunnington.[58]

Third, it was not purely fortuitous that Vigman, who was an officer and the largest shareholder of Bunnington, profited significantly from the Aero Systems manipulation while Holmes, the President and largest shareholder of Aero Systems, was in a position to profit significantly from the Bunnington manipulation.[59]

Fourth, it was Vigman who advised and counseled Holmes concerning the promotion and "hyping" of Aero

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[58] Holmes argues that funds made available by the Aero Systems manipulation could have been left untouched or used for proper purposes without any negative impact on FSSC or Sebag. Opposition Brief, p. 30. Holmes' argument ignores, once again, the underlying conspiracy to manipulate the target securities. In furtherance of the conspiracy, proceeds from the Aero Systems manipulation were used to invest in target securities Bunnington and Aerosonic.

[59] C.R. 1310, pp. 18, 38, ¶¶ 26, 92. Holmes contends that by lifting the selling restrictions on Vigman's April-May 1981 sales of Aero Systems, Holmes merely acted as required by Rule 144 of the Securities Act of 1933. Opposition Brief, p. 52. However, Holmes did much more to assist co-conspirator Vigman. The act itself is normally required. It is the expedited nature of it in the time of crisis that raises the inference that Holmes' acts were abnormal. Further, as Holmes knew, Vigman was timing his sales of Aero Systems to FSSC in April-May 1981 to take full advantage of false press releases reviewed and approved by Holmes and Vigman. C.R. 1317, p. 52, n. 61; C.R. 1310, Exh. "E". Vigman then deferred receipt of the proceeds so co-conspirator Lugo could use the proceeds to continue the manipulation of other target securities. C.R. 1310, pp. 18-19.

Systems stock through false and misleading press releases.[60]

Fifth, there was a close proximity between the successful Aero Systems manipulation (March and April 1981) and the continued Bunnington manipulation (April, May, June, and July 1981).[61]

F. Holmes Cannot Sever The Numerous Links Between His Conduct And That Of His Co-Conspirators.

The central theme running through Holmes' Opposition Brief is that there is insufficient evidence to link Holmes to the conduct of Lugo, Vigman and other co-conspirators who, Holmes concedes and indeed contends, are directly responsible for the injuries to SIPC and the Trustees.[62] None of his examples, however, are the least bit compelling. Rather, each example demonstrates that there are disputed facts and inferences which entitle SIPC and the Trustees to a jury trial.[63]

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[60] C.R. 1317, pp. 44, 49-54.

[61] *Id.*, pp. 58-62.

[62] Opposition Brief, pp. 29, 30, 33-34, 36-41, 44-49.

[63] Holmes contends, *inter alia*, that "the pledging of Aero stock by Sebag and FSSC is not even alleged to have been connected to any conduct by Holmes," that the brokers could have used collateral other than Aero Systems to secure loans to buy target stocks, that Lugo's decision to use the proceeds of sales of inflated Aero Systems stock to buy Bunnington and other target stocks is unconnected to Holmes, and that Holmes' decisions to buy, sell and promote Bunnington were unrelated to the alleged conspiracy. Opposition Brief, pp. 29, 30, 33-46.

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The evidence is more than sufficient to ask a jury to infer that Holmes participated in, and assisted Lugo, Garrity, Vigman and others in, a broad conspiracy and scheme to manipulate the target securities and numerous RICO violations.[64]

The only nexus that Holmes apparently concedes would be sufficient is direct evidence that Holmes knew and approved of the brokers' pledging, that he knew and approved of FSSC's purchases of Bunnington and that he traded and promoted Bunnington with full knowledge of its manipulative impact. This is not the standard. "[O]bvious evidence of such operations is seldom available in any case, for the nature of the fact to be proved, concealed participation, does not lend itself to demonstration by direct evidence."[65] "[I]f the evidence is such that a reasonable jury could return a verdict for the nonmoving party," "summary judgment will not lie."[66] SIPC and the Trustees have met that burden.

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Once again, Holmes has pulled individual pieces of the conspiracy out of context for microscopic inspection. Contrary to his contention, Lugo and Holmes did not act independently in "pursuing [their] own lawful economic objectives." *Id.*, p. 54. Rather, Lugo acted in concert with Holmes, Vigman and others in pursuit of a common purpose – the manipulation of the target securities. SIPC and the Trustees have presented ample evidence supporting a logical inference of such a conspiracy. *See* C.R. 1317; 1310; 1309.

[64] Joint Brief, pp. 1-6.

[65] *Johnson v. Chilcott*, 658 F. Supp. 1213, 1223 (D. Colo. 1987); *See also Miller v. Schweikhart*, 413 F. Supp. 1062, 1065 (S.D.N.Y. 1976).

[66] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

IV.

THE ACTS OF HOLMES AND HIS CO-CONSPIRATORS WERE THE PROXIMATE CAUSE OF INJURY TO SIPC AND THE TRUSTEES

Holmes seeks to divorce his acts from those of the remaining defendants in an effort to escape liability both for his egregious conduct and that of his fellow co-conspirators. To do so, Holmes argues that SIPC and the Trustees must "establish a direct causal relationship between the alleged wrongdoing of the defendant and the injury . . . whether or not there was a broader scheme of which [Holmes'] conduct was a part."[67]

Holmes blithely ignores the time-honored rule that co-conspirators are "liable for the acts of all members of the conspiracy in furtherance of the conspiracy, regardless of the nature of [the conspirator's] own actions."[68] Holmes' position concerning the law of conspiracy is in error. If adopted, it would also be unique and inconsistent with the principles followed in common law and statutory conspiracy claims for relief.[69] Whether analyzed under Rule 10b-5 or RICO, the correct rule is that persons who agree among themselves to break the law and intentionally commit an act in furtherance of the conspiracy

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[67] Opposition Brief, p. 60.

[68] *Beltz Travel Serv. Inc. v. Int'l Air Transp. Ass'n*, 620 F.2d 1360, 1367 (9th Cir. 1980).

[69] *See e.g. Kashi v. Gratsos*, 790 F.2d 1050, 1054-55 (2d Cir. 1986); *Beltz*, 620 F.2d 1360, 1367; *Halbertstam v. Welch*, 705 F.2d 472, 487 (D.C. Cir. 1983); *Rice v. Janovich*, 109 Wash.2d 48, 49-52, 58-62, 64-67, 742 P.2d 1230, 1232, 1236-38, 1239-40 (1987).

are liable for all the damages caused by any other act undertaken in furtherance of the conspiracy.[70]

A. The Proximate Cause Determination In Scheme To Defraud And Conspiracy Cases Is Between The Entire Functioning Scheme And The Loss.

Proximate cause in scheme to defraud and conspiracy cases is not proved by viewing the isolated conduct of each participant and asking whether that conduct alone caused damage. To the contrary, "[i]n a Rule 10b-5 scheme to defraud [cause of action] a plaintiff's injury stems not solely from a particular misstatement or omission but from all interacting elements of the scheme."[71] Further, " 'a conspiracy [is] not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole.' "[72] Therefore, because Plaintiffs have presented a genuine issue of material fact that Holmes conspired with his co-defendants, the correct causation test is to ask whether any act by one of Holmes'

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[70] *Beltz*, 620 F.2d at 1367; *Ferguson v. OmniMedia, Inc.*, 469 F.2d 194 (1st Cir. 1972). Holmes' contention that he never traded through Sebag and never had more than a passing acquaintance with Garrity is of no consequence. Opposition Brief, p. 26, n. 84. Holmes' acts in concert with Lugo suffice to establish his role in the conspiracy. Similarly, Garrity and Sebag assisted Lugo and FSSC in the conspiracy to manipulate the target securities. C.R. 1310, p. 31, ¶ 71.

[71] *Kafton v. Baptist Park Nursing Center, Inc.*, 617 F. Supp. 349, 350 (D. Ariz. 1985), *citing Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974).

[72] *Beltz*, 620 F.2d at 1366 (citations omitted).

co-conspirators caused Plaintiffs' damages. It is not necessary for Plaintiffs to demonstrate that any overt act of Holmes is the proximate cause of Plaintiffs' injury.

For example, in *Halberstam v. Welch*,[73] the court found that a civil conspiracy existed to commit burglary and sell the stolen goods. The defendant performed services as a bookkeeper for the scheme, and had lived with the burglar for a number of years. During one of the burglaries, a killing took place. In the wrongful death action, plaintiff alleged that the killing during the commission of a burglary was within the scope of the conspiracy to steal goods in order to sell them later. The District of Columbia Circuit held:

> A conspirator can be liable even if he neither planned nor knew about the particular overt act that caused injury, so long as the purpose of the act was to advance the overall object of the conspiracy.[74]

As set forth above, the District Court expressly found a genuine issue of material fact that Holmes agreed to violate RICO. Plaintiffs have also presented evidence that Holmes undertook overt acts in furtherance of the conspiracy. The appropriate causation nexus in such a case must be between the entire scheme and all the acts of the conspirators and the harm "so long as the purpose of the act was to advance the overall object of the conspiracy."[75] This includes liability on Holmes' part for the acts of

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[73] 705 F.2d 472, 487 (D.C. Cir. 1983).

[74] *Halberstam*, 705 F.2d at 487; *see also Beltz*, 620 F.2d at 1367.

[75] *Id.*

Lugo, Vigman, Garrity, and other defendants undertaken in furtherance of the agreement to manipulate securities and violate RICO.

Bloor v. Carro, Spanbock, Londin, Rodman & Fass,[76] cited by Holmes, has no impact upon the principles of conspiracy and causation at issue in this case. The plaintiff-trustee in *Bloor* did not allege a conspiracy against the defendant law firm. The trustee in *Bloor* brought a lawsuit against a number of defendants, including Peat, Marwick & Main, accountants for the filed Investment Funding Corporation of New York, and Carro, Spanbock, the firm's lawyers. In addressing the claims made against the law firm, the Second Circuit noted "[t]he district court found that the Trustee's claims against the law firm suffered from the same causation defects as those against PMM."[77] A review of the allegations against Peat, Marwick clearly reveals that the trustee never alleged any conspiracy claim against the accountants.[78] The district court never addressed the law of causation in conspiracy cases as to the law firm because, if it had, the court would have applied principles of causation applicable to conspiracy cases, instead of the principles applicable to non-conspiracy cases such as that brought against Peat, Marwick. The district court did not address issues of conspiracy with respect to either the accountants or the law firm. In contrast, as set forth above and as expressly found by

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[76] 754 F.2d 57 (2d Cir. 1985)

[77] *Bloor*, 754 F.2d at 60. *See also In re Investors Funding Corp. of New York Secs. Lit.*, 566 F. Supp. 193, 201 (S.D.N.Y. 1983).

[78] *In re Investors Funding Corp. of New York Secs. Lit.*, 523 F. Supp. 533, 542 (S.D.N.Y. 1980).

the District Court below, Plaintiffs herein have already presented a genuine issue of material fact that Holmes violated RICO and agreed with others to do so. Holmes' attempt to carve out his culpable conduct as if no conspiracy exists must therefore be rejected.

Holmes attempts to assert that loss causation between his acts and the damages sustained is required in this conspiracy case; however, Holmes never addresses the causation requirements of the RICO claims against him. Further, Holmes conveniently ignores the rule that conspirators are liable for the acts of their co-conspirators undertaken to further the illegal agreement. The District Court found genuine issues of material fact that Holmes violated each subsection of RICO and conspired with his co-defendants to do so.[79] Holmes ignores these findings in an effort to sweep RICO's broad remedial frame work under the restrictive rug of "loss causation."

The standard is clear: persons who conspire to violate RICO are liable for all loss caused "by reason of" the act of any co-conspirator. Holmes cannot escape the simple standard that injury caused by reason of the violation is actionable under Section 1964(c). Further, Holmes has no authority for his implied assertion that plaintiffs in a civil conspiracy case must "establish a direct causal relationship"[80] between his conduct and the loss because the law is exactly the opposite. Therefore, the grant of summary judgment should be reversed and this case remanded for trial.

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[79] C.R. 1343, p. 2 ¶¶ 1-5.

[80] Opposition Brief, p. 60.

B. Holmes Was An Integral Player In The Conspirarcy [sic] And Scheme To Defraud, Unlike The Defendants In *Bloor* and *Miller*.

Holmes erroneously cites to *Bloor* and *Miller v. Schweickhart*[81] for the proposition that Plaintiffs must present a triable issue that Holmes' activities, in isolation, were the proximate cause of the massive damage sustained in this case.[82] In doing so, Holmes misreads *Bloor* and disingenuously misrepresents the nature and scope of the proof against him. Holmes also ignores the factual dissimilarities of *Miller* which, on its facts, has little to do with this case. Further, Holmes conveniently minimizes the RICO allegations against him in an attempt to rid himself of responsibility for the criminal conduct at issue in this case and the harm proximately caused by the culpable acts.

In *Bloor*, a bankruptcy trustee alleged that the law firm representing Investors Funding Corporation of New York had assisted in the preparation of SEC registration statements, 10-Ks, annual reports and proxy statements which failed to disclose or misrepresented material information. Funds invested by misled investors were later "allegedly funneled into unwise investments or diverted. . . . "[83] Bloor's only factual allegation concerning causation was that but for the infusion of funds as a result of the misleading documents, the principals of the defunct investment firm would not have had any funds

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[81] 413 F. Supp. 1062 (S.D.N.Y. 1976).

[82] Opposition Brief, pp. 54-61.

[83] *Bloor*, 754 F.2d at 62.

with which to " 'perpetrate and maintain the Fraud.' "[84] The Second Circuit agreed with the defendant's argument, holding that "the failure of the corporation to use proceeds wisely or the theft of corporate funds by officers was hardly a reasonably foreseeable result, let alone a direct result" of the law firm's activities.[85]

Bloor cannot be authority for the affirmance sought by Holmes because it did not address legal or factual issues comparable to those present in this case. First, *Bloor* did not involve persons who conspired to violate RICO. In fact, *Bloor* is not a conspiracy case.[86] Second, *Bloor* is readily distinguishable on its facts because of the *de minimus* involvement of the defendant law firm in the harm sustained by Investors Funding Corporation. In contrast, SIPC and the Trustees have presented evidence that Holmes committed overt acts in furtherance of the conspiracy and affirmatively acted to perpetrate the stock manipulations.

Moreover, the Second Circuit held in *Bloor* that the defendant law firm could not have foreseen the theft of corporate funds by others. In contrast, it was foreseeable to Holmes that the damage sustained by Plaintiffs would

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[84] *Id.*

[85] *Id.*

[86] Plaintiffs herein have presented evidence, and the district court expressly found, that Holmes invested illicitly gained income into an enterprise, obtained control over an enterprise through illegal acts, associated with an enterprise and conducted its affairs through a pattern of racketeering and conspired with his co-defendants to violate RICO. C.R. 1343, p. 2, ¶¶ 1-5.

occur as a result of the conspiracy.[87] Holmes' assistance in manipulating Bunnington stock created the foreseeable result that the brokerage houses would sustain losses.[88] Holmes' parking of stock for Lugo created the foreseeable result that the capital troubles of FSSC would be worsened. Therefore, unlike the defendant law firm in *Bloor*, adverse consequences as a result of Holmes' acts and the acts of his co-conspirators were likely if not certain to occur. Plaintiffs therefore present a genuine issue that Holmes' acts, and those of his co-conspirators, created a foreseeable loss to SIPC and the Trustees, further necessitating a reversal of the order of summary judgment.

Holmes cites to *Miller* and argues that the instant case is somehow analogous to the facts in *Miller*. However, even a cursory review of the factual allegations of *Miller* reveals that the last allegedly culpable transaction in that case took place two and one-half years before the damage was sustained. The court held as follows:

> The considerations that are important in applying the "substantial" or "essential" factor test [of proximate cause], such as lapse of time,

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[87] Holmes misleading and erroneously contends that the demise of FSSC and Sebag was, according to Plaintiffs' theory, a "calculated result" of the conspiracy. Opposition Brief, p. 29. Plaintiffs have never ascribed such a plan to the conspiracy. In any event, the demise of FSSC and Sebag were foreseeable consequences of the acts of the conspiracy whether or not intended.

[88] Indeed, FSSC traded on and promoted protection by SIPC by the use of SIPC's logo on trade confirmations and statements. *See e.g.*, C.R. 1317, Exh. 9001. Thus, not only was loss to SIPC in the event of failure foreseeable, but clearly probable and predictable as a result of the failures.

> the number and impact of other factors and the extent to which the defendant's conduct created a continuous and active potential for harm, all counsel against a finding of proximate cause in these circumstances.[89]

Understandably, the district court in *Miller* held that the remote transactions could not have caused harm to the brokerage some two and one-half years later.[90]

In stark contrast, the facts before this Court show that Holmes was involved with the manipulative scheme, invested illicit income into an enterprise, and conducted the affairs of FSSC and Sebag through a pattern of racketeering activity, at the precise time that the firms collapsed. There was no lapse of time between Holmes' overt acts and the loss. Further, Holmes' conduct in manipulating Bunnington stock created exactly the active potential for harm missing in *Miller*. Thus, *Miller* is not valid authority for the summary judgment granted by the District Court.

C. Holmes Is Secondarily Liable For Aiding And Abetting Securities Laws and RICO Violations.

Holmes ignores the substantial evidence that he aided and abetted the target securities manipulations, and is secondarily liable for the acts of his co-defendants also underlying the manipulations. Holmes does not contest the existence of an independent primary wrong, *i.e.*,

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[89] *Miller*, 413 F.Supp. at 1068.

[90] 413 F.Supp. at 1067-68 (S.D.N.Y. 1976).

the manipulation of Bunnington stock;[91] however, Holmes fails to acknowledge that his actual knowledge of the manipulation and "substantial assistance" are uniquely fact-intensive questions inappropriate for resolution on summary judgment.

Both RICO and Rule 10b-5 allow secondary liability based upon a defendant's status as an aider and abettor.[92] Holmes' extensive participation in the affairs of the FSSC-Sebag enterprise, and his affirmative assistance to others in violating RICO and Rule 10b-5, directly undermine the argument that proximate cause has not been shown here. Reversal and remand for trial is therefore appropriate.

V.

THE DECLARATIONS OF EXPERTS FOLEY AND TORKELSON AND PLAINTIFFS' STATEMENT OF BACKGROUND AND FACTS DEMONSTRATE GENUINE ISSUES OF MATERIAL FACT AND WERE PROPERLY CONSIDERED BY THE DISTRICT COURT

Holmes claims that the declarations of Plaintiffs' experts James C. Foley ("Foley") and John B. Torkelson ("Torkelson") (the "Declarations"), and the Statement of Background and Facts (the "Statement"), submitted by Plaintiffs in opposition to Holmes' motions for summary judgment do not satisfy the requirements of Federal Rule

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[91] In fact, Holmes affirmatively asserted below that the Bunnington manipulation caused the collapse of the FSSC and Sebag. *See* C.R. 1281 at 12-13.

[92] *See DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 188 (9th Cir. 1987) (Rule 10b-5) and *Petro-Tech, Inc. v. Western Co. of North America*, 824 F.2d 1349, 1358-62 (3rd Cir. 1987) (RICO).

of Civil Procedure 56(e), and are therefore inadmissible as evidence.[93]

In his reply to Plaintiffs' Opposition to Motion for Summary Judgment filed in the District Court,[94] Holmes objected to the Declarations on the grounds that they contained impermissible opinions and legal conclusions as to Holmes' motives and failed to attach authenticated copies of documents relied upon.[95] However, the trial court did not exclude any of Plaintiffs' evidence. The documents are properly part of the record before the Court on appeal.

A. The Declarations Are Admissible.

1. Experts May Opine On Ultimate Issues.

Holmes claims that the Declarations do not comply with the requirements of Federal Rule of Civil Procedure 56(e) because the declarants testify as to ultimate facts and conclusions of law, and opine as to Holmes' motives.[96] He also objects to the Declarations on the

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[93] Opposition Brief, pp. 8-13. Although both Declarations state the background, qualifications and expertise of the declarants, Holmes claims that Foley and Torkelson impermissibly testify as to "legal conclusions." The Declarations state that they are offered as the testimony of the experts designated by Plaintiffs, and the opinions and conclusions by Foley and Torkelson are given by persons who are qualified as experts in the customs and practices of the securities industry.

[94] C.R. 1326 at 2-3.

[95] Holmes also objected to the Statement on the ground that it exceeded the maximum number of pages allowed by the Local Rules of Practice. C.R. 1326, pp. 2-3.

[96] Opposition Brief, p. 10.

grounds that the documents referenced by Foley and Torkelson were not attached to the Declarations.[97] Holmes' position is squarely in opposition to the law of the Ninth Circuit.

The cases[98] Holmes relies on to support his claim that Foley and Torkelson impermissibly testify in their Declarations as to legal conclusions, ultimate issues and Holmes' motives are inapplicable here. The cases discuss only the limitations on a *non-expert's* testimony. Holmes' contention that such opinions are barred even where the declarant is an expert, is based on a single district court case from Nevada.[99] The law of the Ninth Circuit is clear, however, that both the permissible scope and substance of an expert's testimony (by declaration or otherwise) are indisputably broader than those of a percipient witness. This increased range of areas on which an expert may testify as to his conclusions and opinions is embodied in Federal Rules of Evidence 703, 704(a) and 705 and is set forth clearly in many Ninth Circuit cases.

For example, in *Bieghler v. Kleppe*,[100] the plaintiffs were injured in a motorcycle accident. The plaintiffs sued the United States, which moved for summary judgment. The plaintiffs opposed the motion and filed the affidavit of an accident reconstruction expert who opined that the accident was caused by defective lighting in a tunnel. On

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[97] *Id.*, p. 9.

[98] *Cermetek, Inc. v. Butler Aupah, Inc.*, 573 F.2d 1370 (9th Cir. 1978); *Washington v. Maricopa County*, 143 F.2d 871 (9th Cir. 1944); *Sanders v. Douglas*, 565 F.Supp. 78 (C.D. Cal. 1983).

[99] *Condos v. Conforte*, 596 F. Supp. 197, 199 (D. Nev. 1984).

[100] 633 F.2d 531 (9th Cir. 1980).

appeal from summary judgment in favor of defendants, the *Bieghler* defendants, like Holmes, contended that the affidavit of plaintiffs' expert was "conclusory, based on hearsay, and not within personal knowledge, and otherwise [contained] inadmissible opinion evidence."[101]

This Court noted that pursuant to Federal Rule of Civil Procedure 56(e), affidavits submitted in support of or in opposition to a summary judgment motion must be " 'made on personal knowledge, . . . set forth such facts as would be admissible in evidence, and show affirmatively that the affiant is competent to testify to the matters stated therein.' "[102] The *Bieghler* Court held, however, that:

> Rules 702, 702, 704, and 705 of the Federal Rules of Evidence dispose of defendants' argument. Rules 702 and 704 allow properly qualified experts to testify in the form of an opinion about issues as to which their expertise may assist the trier of fact, even if the opinion embraces an ultimate issue of fact. Rule 703 permits the expert to base opinions or inferences on facts or data not admissible in evidence if they are of a type reasonably relied upon by experts in the field. Rule 705 permits an expert to give opinion testimony without prior disclosure of the underlying facts or data.
>
> The expert's affidavit here affirmatively showed his qualifications as an expert in accident reconstruction and the study he had undertaken to form his opinions. Although it did not describe in detail how he had arrived at his

[101] *Id.* at 533.

[102] *Id., quoting* Fed. R. Civ. P. 56(e).

> conclusions, the affidavit gave more than a bare conclusion that defendants had been negligent and that their negligence caused the accident.[103]

In *Shad v. Dean Witter Reynolds Inc.*,[104] the Shads brought an action against the defendant brokerage firm and their stockbroker, alleging that their account had been "churned." The trial court allowed Shads' expert to testify only as to "objective" matters such as the definition of churning and to identify trading patterns in the Shads' accounts.[105]

Additionally, the trial court did not allow Shads' expert to state his opinion as to the ultimate issues in the case, whether the trading was excessive and therefore whether the accounts had been churned. The expert was also precluded from testifying regarding "the significance of various types of transactions, whether they were appropriate to the Shads' circumstances and objectives, and whether the making of those transactions evidenced reckless disregard of the Shads' interests."[106] The Shads' expert was similarly prevented from testifying regarding defendants' motives in trading the accounts and from stating the opinion that defendants' only purpose was to earn commissions.[107]

The Ninth Circuit held that it was prejudicial error for the trial court to exclude the opinions of the Shads' expert on the ultimate issues of whether the account had

[103] *Id.*

[104] 799 F.2d 525 (9th Cir. 1986).

[105] *Id.* at 527.

[106] *Id.*

[107] *Id.* at 528.

been churned and whether the broker had acted with reckless disregard or "scienter." This Court found that the Shads' expert should have been allowed to state his opinion on a wide range of issues, including whether the broker "controlled" the account, whether he engaged in "excessive trading" and the issues of "risk, comparative suitability and trading patterns."[108] The Court also authorized the Shads' expert to offer his inferences and conclusions, which he had drawn from the evidence, as to the broker's motives, whether the broker "intended to defraud" the Shads, or whether he acted with "reckless disregard" for their interests because "[s]cienter usually will not be established by direct evidence, but rather will be inferred from a finding of excessive trading and control. The reasons for allowing expert testimony regarding control and excess trading are equally applicable to scienter."[109]

It is thus well established under the law of the Ninth Circuit that, contrary to Holmes' assertion, an expert may state his opinion as to conclusions, ultimate issues and a party's motives or intent.[110] Holmes' objection to the expert affidavits must therefore be overruled.

2. Documents Relied On By An Expert Need Not Be Attached To An Expert's Declaration.

Holmes objects to the Declaration on the basis that the documents referenced by Foley and Torkelson are not

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[108] *Id.* at 530.

[109] *Id.*

[110] *Id.* at 527-30; *Bieghler*, 633 F.2d at 533-34; *See also Bulthuis v. Rexall Corp.*, 789 F.2d 1315, 1318 (9th Cir. 1985); *Pacific Legal Found v. State Energy Resources, etc.*, 659 F.2d 903, 912 n.15 (9th Cir. 1981), *cert. denied*, 457 U.S. 1133 (1982).

attached and authenticated pursuant to Rule 56(e). This objection similarly is without merit. Federal Rule of Evidence 705 provides in pertinent part that "the expert may testify in terms of opinion or inference and give reasons therefor without prior disclosure of the underlying facts or data, unless the court requires otherwise."

In *Bulthuis*, the lower court rejected the affidavits of two doctors in opposition to defendant's motion for summary judgment on the grounds that the doctors failed to state the facts on which their medical opinions were based.[111] This Court found that although the doctors did not describe in detail how they arrived at their opinions, they sufficiently explained that their opinions were based on changes that they had observed in the plaintiff's tissue. In reversing the lower court, the Ninth Circuit held:

> Expert opinion is admissible and may defeat summary judgment if it appears the affiant is competent to give an expert opinion and the factual basis for the opinion is stated in the affidavit, even though the underlying factual details and reasoning upon which the opinion is based are not. If further facts are desired, the movant may request and the district court may require their disclosure. In this case, both experts stated their opinions were based on observed tissue changes and no greater detail was requested. The affidavits should have been considered.[112]

Under Federal Rule of Evidence 705 and the holding of *Bulthuis*, Foley and Torkelson, as experts, were not

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[111] *Bulthuis*, 789 F.2d at 1317-18.

[112] *Id.* at 1315.

required to attach and authenticate the documents. In addition, contrary to Holmes' claim that the referenced documents must be attached and authenticated in order for the testimony concerning or based on such documents to be admissible, Federal Rule of Evidence 703 provides in pertinent part that "[i]f of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence." Moreover, in the proceeding below, neither Holmes nor the District Court requested the presentation of additional factual bases for experts' opinions. The Declarations are therefore admissible.

B. The Statement Of Background And Facts And Its Appendix Of Exhibits Are Properly Part Of The Record.

Holmes objects to Plaintiffs' Statement of Background and Facts on the grounds that it fails to satisfy the requirements of Federal Rule of Civil Procedure 56(e)[113] and that its contents are immaterial to the issues presented by his summary judgment motion.[114]

Holmes claims that the Statement is inadmissible because it does not conform to the requirements of Rule 56(e); however, he also acknowledges that the Statement "is not an affidavit or declaration."[115] Rule 56(e), however, only sets forth the requirements for an affidavit in

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[113] Opposition Brief, p. 8.

[114] *Id.* at 13.

[115] *Id.*

support or in opposition to a summary judgment motion. The Statement is not, as Holmes acknowledges, an affidavit or declaration. It is clearly a narrative exposition of the facts, supported by evidence filed in opposition to Holmes' motions for summary judgment (which is presently in the record before this Court), and is signed by counsel for Plaintiffs as such.

Since the Statement is not an evidentiary document and need not conform to Rule 56(e), what remains of Holmes' objection to the Statement is that it "is a work of historical fiction."[116] The essence of Holmes' objection to the Statement is, therefore, that Plaintiffs have suggested inferences and conclusions based upon the underlying facts concerning Holmes' role in the scheme with which Holmes disagrees. In *Miller v. Schweickhart*,[117] cited by Holmes, the Court discussed the inferences that a fact finder may draw from established facts. The court held that:

> It is recognized, of course, that . . . [the defendant's] categorical denials of wrongdoing are by no means conclusive, and by themselves do not require the granting of defendant's motion for summary judgment. . . . The Court also recognizes that the absence of direct evidence is not fatal to plaintiffs' claim – indeed it is fully aware that conspiracies are rarely established by direct evidence; that usually they are spelled out by independent circumstantial evidence and the reasonable inferences to be drawn therefrom. . . .

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[116] *Id.* at 12.

[117] 413 F. Supp. 1062 (S.D.N.Y. 1976).

> A fact finder may draw reasonable inferences from known or proven facts, but the inference must be based on common experience and be logical or reasonable. . . . [118]

The fact that Holmes interprets the same factual evidence differently than Plaintiffs merely illustrates that there are dramatically different interpretations and conclusions that a fact finder can reasonably draw from the same evidence.

Holmes argues that the Statement does not constitute admissible evidence.[119] Holmes has acknowledged, however, that the Statement was accompanied by eight volumes of exhibits which are referenced in the Statement, and which were designated as part of the record on this appeal.[120]

In addition, Holmes did not object to the admissibility of any of the attached exhibits in the District Court, nor has he raised any objection to the eight volumes of exhibits on appeal. Federal Rule of Evidence 103 provides that "in case the ruling is one admitting evidence, a timely objection or motion to strike [must state] the specific ground of objection if the specific ground was not apparent from the context." No such objection was made and none appears in the record. Judge Wright has described the "well-settled rule that affidavits not in compliance with Rule 56(e) may be considered by the trial court in the absence of an objection by counsel."[121] In the

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[118] *Miller*, 413 F. Supp. at 1065.

[119] Opposition Brief, p. 13.

[120] *Id.*

[121] *United States v. Dibble*, 429 F.2d 598, 603 (9th Cir. 1970) (J. Wright, concurring).

absence of such an objection, the exhibits constitute part of the record on appeal and should be considered by the Court along with the Statement, as they were considered by the District Court.

VI.

CONCLUSION

For the reasons set forth in the Opening and Reply Briefs, and in the SEC's Amicus Curiae Brief, this Court should reverse the order of summary judgment and remand the case for trial. SIPC and the Trustees must be allowed to try their cases against Holmes.

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No. 90-727

In The

Supreme Court of the United States

October Term, 1990

ROBERT G. HOLMES, JR.,

Petitioner,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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QUESTIONS PRESENTED

1. Whether a person who asserts a claim under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), predicated upon violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and who was neither a purchaser nor a seller of securities and for that reason lacked standing to sue under Section 10(b) and Rule 10b-5, is injured "in his business or property by reason of" such violations, sufficient to acquire standing to sue for essentially the same claims under RICO.

2. Whether a person has standing under RICO to complain of injury by racketeering activity which consists of offenses by the defendant "involving fraud in the sale of securities," when the person was neither a purchaser nor seller of securities.

3. Whether a person, who is neither a purchaser nor a seller of securities, and therefore lacks standing to sue under Exchange Act Section 10(b) and Rule 10b-5, should be permitted to circumvent that limitation on standing by claiming essentially the same conduct as predicate acts of mail and wire fraud.

LIST OF PARTIES

The petitioner is Robert G. Holmes, Jr. Respondents are the Securities Investor Protection Corporation, Eugene W. Bell, trustee for the liquidation of Joseph Sebag Incorporated, and Laurence A. Schroeder, successor trustee for the liquidation of First State Securities Corporation.

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OPINIONS BELOW

The Opinion and Judgment of the United States Court of Appeals for the Ninth Circuit was entered on August 3, 1990, is reported at 908 F.2d 1461 (9th Cir. 1990) and is printed in Appendix A of the Petition for Writ of Certiorari ("Pet. App. A") at page 1a. The Orders for Summary Judgment of the United States District Court for the Central District of California are printed in Pet. App. A, at pages 22a-46a. Other opinions, not at issue on this writ of certiorari, rendered at earlier points in this case by the United States Court of Appeals for the Ninth Circuit are reported at 764 F.2d 1309 (9th Cir. 1985) and at 803 F.2d 1513 (9th Cir. 1986) and are printed in Pet. App. A, at pages 64a and 46a, respectively.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit (Pet. App. A, at page 1a) was entered on August 3, 1990. The Petition for Writ of Certiorari was filed on November 1, 1990 and was granted on April 22, 1991 limited to Question 1 of the Petition relating to whether a person who is neither a purchaser nor seller of securities and lacks standing under the Exchange Act may sue for essentially the same conduct under RICO. The jurisdiction of the Supreme Court is invoked under 28 U.S.C.A. §1254(1) (West 1966 & Supp. 1991).

STATUTES INVOLVED

1. The Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C.A. §§1961-1968 (West. 1984), printed in Pet. App. A, at page 86a.

2. The Securities Exchange Act of 1934, 15 U.S.C.S. §78j(b) (Law. Co-op. 1983), and Securities and Exchange Commission Rule 10b-5, 17 CFR §240.10b-5, printed in Pet. App. A, at page 97a.

3. The Securities Investor Protection Act, 15 U.S.C.S. §§78aaa-78lll (Law. Co-op. 1983), printed in Pet. App. A, at page 98a.

STATEMENT OF THE CASE

I.

Background

In 1981, the Securities Investor Protection Corporation ("SIPC") placed two securities brokerage firms, First State Securities Corporation ("FSSC") and Joseph Sebag, Inc. ("Sebag") in liquidation, pursuant to the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§78aaa-78lll, when FSSC and Sebag failed to meet statutory net capital requirements. SIPC appointed trustees to administer the liquidation of FSSC and Sebag and to return customer property and settle customer claims against the brokerage firms.

In 1983, SIPC and the trustees brought this action against Petitioner Robert G. Holmes, Jr. ("Holmes") and seventy-five other defendants to recover payments made allegedly as a result of conspiracy among the defendants to manipulate, through FSSC and Sebag, the prices of

securities of six publicly traded corporations. SIPC and the trustees asserted claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-1968 ("RICO") and the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b) and Rule 10b-5 promulgated thereunder.[1]

II.

The Parties In The Courts Below

Petitioner Holmes is the founder, chief executive officer, president and a major shareholder of Aero Systems, Inc. ("Aero"). Aero is one of the six corporations whose stock SIPC alleges was manipulated.

SIPC was established in 1970 by the Congress pursuant to the SIPA. Among other purposes, SIPC was empowered to reimburse customer claims when member securities brokerages went into liquidation due to financial failure and had insufficient assets to meet customer claims. SIPC alleges that it had to disburse nearly $13,000,000 to meet claims of customers of FSSC and Sebag which FSSC's and Sebag's assets were insufficient to satisfy. SIPC sued Holmes and other defendants to recover payments required to be made by SIPC to certain customers of the failed brokerage firms. The trustees, the other appellants below, were appointed to liquidate FSSC and Sebag and separately sued Holmes and others for the destruction of the business and loss of goodwill of FSSC and Sebag.

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[1] RICO, 18 U.S.C.A. §§1961-1968 (West 1984), is printed in Pet. App. A, at page 86a; Exchange Act Section 10(b), 15 U.S.C.S. §78j(b) (Law. Co-op. 1983) and Rule 10b-5, 17 CFR §240.10b-5, are printed in Pet. App. A, at pages 97a and 98a respectively.

In addition, customers of FSSC and Sebag, who were purchasers or sellers of the allegedly manipulated securities, brought a separate class action against Holmes and the other defendants, which action has been partially resolved by settlement with Holmes and certain other defendants.

III.

The Proceedings Below

Holmes moved for summary judgment in the District Court for the Central District of California (the "District Court") on the grounds, among others, that SIPC had no standing to maintain claims against him under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC was not a purchaser or seller of the allegedly manipulated securities. Holmes also asserted that he was not liable to either SIPC or to the trustees because his acts, taken alone or in conjunction with those of others, were not the proximate cause of the financial failure of the brokerages. Holmes also argued that SIPC and the trustees had no standing under RICO to sue him for the failure of the brokerage firms because SIPC's and the trustees' damages were not caused "by reason of" the alleged RICO violations. Furthermore, SIPC did not have standing to assert RICO claims against Holmes which were predicated upon Holmes' alleged offenses under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC, not having been a purchaser or seller of the securities, had no standing to assert the alleged predicate claims.

In the courts below, SIPC and the trustees argued that Holmes, acting in concert with others, caused the demise of

FSSC and Sebag by artificially inflating the price of Aero's stock through the issuance of false and misleading press releases. The plaintiffs argued that the alleged inflated price of Aero stock enabled the brokerages to acquire massive inventories of other allegedly manipulated stock. The plaintiffs argued that these excess inventories, together with a conspiracy in which Holmes and others allegedly participated involving another security, Bunnington Corporation, were the reason for FSSC's and Sebag's failure because the price of the stocks dropped when the alleged manipulations were discovered.

Holmes denied inflating the price of Aero's stock artificially or participating in any manipulation of Bunnington Corporation securities and argued that even if he did, that manipulation was not the cause of the failure of the brokerages. The failure of the brokerages was caused by wrongdoing of Joseph Lugo, a principal and brokerage officer of FSSC and Rodger Garrity, a former brokerage officer of Sebag, who manipulated securities between themselves and engaged in other wrongdoing, none of which involved Holmes.

A. The District Court's Rulings

In ruling on Holmes' motions for summary judgment, the District Court concluded that Holmes' conduct was not sufficiently connected to SIPC's nor the trustees' losses to have been a proximate cause of those losses. The District Court also ruled that SIPC had no standing to assert RICO claims predicated upon violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC had not carried its burden of proof under *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), to show that it

was a purchaser or seller of securities. *See* District Court's Conclusions of Law, printed in Pet. App. A, at pp. 27a-28a. Furthermore, the District Court concluded that Holmes was entitled to summary judgment with respect to both the Exchange Act claims and the RICO claims because Holmes' conduct was not causally connected to SIPC's or the trustees' losses. The District Court granted summary judgment to Holmes on both the Rule 10b-5 and the RICO claims for the reasons that SIPC had not shown that it was a purchaser or seller of securities and there was lack of a causal nexus between Holmes' conduct and the plaintiffs' losses.

B. The Ninth Circuit's Reversal

The Court of Appeals for the Ninth Circuit reversed the District Court's ruling and held that SIPC need not have been a purchaser or a seller of securities in order to acquire standing to assert RICO claims predicated upon Holmes' alleged violations of Exchange Act Section 10(b) and Rule 10b-5. The Ninth Circuit also reversed the District Court's ruling that Holmes' conduct was not a proximate cause of the plaintiffs' injuries. This Court granted a writ of certiorari with respect to the Ninth Circuit's holding that SIPC need not have been a purchaser or seller of securities to assert claims under RICO predicated upon allegations against Holmes of offenses involving fraud in the sale of securities.

SUMMARY OF ARGUMENT

It is inherent in the civil RICO standing provision, §1964(c), which confers standing on a person "injured in

his business or property," that the injury be "direct." A person who is neither a purchaser nor seller of securities is not directly injured in a "fraud in the sale of securities."

Civil RICO standing exists only when the claimant was injured "by reason of" the predicate act of racketeering activity. A person who is neither a purchaser nor seller of securities is not sufficiently causally connected to a fraud in the sale of securities to satisfy this requirement.

RICO §1964(c), which contains the civil RICO standing provision, incorporates by reference the purchaser-seller standing requirement when it incorporates by reference the body of law pertaining to "fraud in the sale of securities."

The only definition of "racketeering activity" in RICO which relates to securities, "fraud in the sale of securities," is the most narrowly defined of the approximately 36 predicate acts set forth in RICO. Such purposeful circumscription evidences an intention to preserve existing appropriate standing limitations.

In adopting civil RICO, Congress did not intend to emasculate or trivialize the Exchange Act by overruling well-settled and widely accepted standing provisions contained in existing judicial decisions under the Exchange Act.

Judicial policy considerations are appropriately referred to in resolving the question at hand. To avoid vexatious litigation, discovery abuse, strike suits, settlement pressure, extortion and judicial system abuse, the purchaser-seller standing requirement should be preserved when "fraud in the sale of securities" is alleged as a predicate act of "racketeering activity."

The purchaser-seller standing requirement for fraud in the sale of securities should not be subject to circumvention merely by pleading wire or mail fraud in connection with the same conduct.

ARGUMENT

I.

INTRODUCTION

Standing serves as the gatekeeper to the judicial forum. It admits those entitled to pursue their grievances and bars those who are not. Entry, through standing, is administered by judges applying principles of law, rather than by triers of fact, even though some of the same questions resolved in the context of standing, such as causation and whether the claimant sustained direct injury, could be and sometimes are resolved as factual issues.

Some precepts of standing have evolved into settled and widely accepted principles of law. The opinion in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952) and this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), developed the principle that a person or entity must be a purchaser or seller of securities to have standing to sue under Exchange Act §10(b) and the related Rule 10b-5, and that principle has become solidly embedded in federal securities jurisprudence. On this writ, petitioner asks this Court to determine whether the principles of standing enunciated in *Birnbaum* and *Blue*

Chip Stamps are applicable when "fraud in the sale of securities" set forth at RICO §1961(1)(D) is relied upon under RICO §1964(c) as the "racketeering activity" which violates RICO §1962.

Without persuasive analysis, the Ninth Circuit decision below emasculated the principles established in *Birnbaum* and *Blue Chip Stamps* when securities fraud is used as a predicate act of racketeering activity and that decision undermines the stability and predictability of a well-settled body of law. The Ninth Circuit, while purportedly basing its decision on the language of RICO, in fact ignored the realistic plain meaning of that statute. An examination of the language of RICO, related congressional history and appropriate policy considerations indicates that, contrary to the ruling below, a person or entity that is neither a purchaser nor seller of securities and who or which, for that reason lacks standing under the Exchange Act to sue for fraud in the sale of securities, similarly lacks standing to claim injury by "fraud in the sale of securities" as "racketeering activity" under RICO.

II.

A PERSON SUCH AS SIPC HERE, WHO ALLEGES FRAUD IN THE SALE OF SECURITIES AS A RICO PREDICATE ACT, BUT WHO WAS NEITHER A PURCHASER NOR SELLER OF SECURITIES, CANNOT HAVE BEEN "INJURED IN HIS BUSINESS OR PROPERTY" WITHIN THE MEANING OF RICO §1964(c) AND FOR THAT REASON LACKS STANDING TO CLAIM THE FRAUD AS A PREDICATE ACT OF RACKETEERING ACTIVITY.

RICO §1964(c), commonly referred to as the core of the civil RICO provisions, contains the standing

requirement for civil RICO. It provides that "[a]ny person injured in his business or property by reason of a violation of §1962 . . . may sue therefor . . . . " RICO §1962 prohibits using or investing the proceeds of a pattern of racketeering activity (RICO §1962(a)), using a pattern of racketeering activity to acquire an interest in or to maintain control of an enterprise (RICO §1962(b)(1)), conducting or participating in an enterprises's affairs through a pattern of racketeering activity (RICO §1962(c)), or conspiring to violate any of the foregoing (RICO §1962(d)). Thus, determining the existence of "racketeering activity" is essential to determining whether there has been a violation of RICO §1962 and, accordingly, whether there is standing to invoke civil RICO under §1964(c). "Racketeering activity" is defined to include "any offense" involving "fraud in the sale of securities . . . punishable under any law of the United States." RICO §1961(1)(D).

It has consistently been held in several circuits that only the party directly injured has standing to invoke civil RICO.[2] For example, when a corporation is injured by an act of racketeering activity, a shareholder of the injured corporation may not bring an individual claim in his capacity as a shareholder for the diminution in the value of his shares. Only the injured corporation is the directly injured party and has standing to invoke civil RICO. *See Rylewicz v. Beaton Serv., Ltd.*, 888 F.2d 1175

[2] *See, e.g. National Enter. Inc. v. Mellon Fin. Ser. Corp.*, 847 F.2d 251 (5th Cir. 1988); *Morast v. Lance*, 807 F.2d 926 (11th Cir. 1987); *Illinois v. Life of Mid-America Ins. Co.*, 805 F.2d 763 (7th Cir. 1986); *Warren v. Manufacturers Nat'l Bank of Detroit*, 759 F.2d 542 (6th Cir. 1985).

(7th Cir. 1989). Indeed, "[t]he standing rule that stockholders may not bring individual claims under RICO for diminution in the value of the corporation prevails in all the Circuits that have considered the matter." *Id.* at 1179.[3]

A principle reason for granting standing only to the directly injured party is to prevent multiple recoveries for the same injury. For example, when the victim is a corporation, if its shareholders, employees and suppliers were each individually considered to be a "person injured in his business or property" entitled to assert a civil RICO claim for the same injury, there could be innumerable recoveries, each with treble damages. No such result was intended by Congress or has been countenanced by the courts.

The requirement for a "direct injury" to the plaintiff in order for the plaintiff to have standing was applied in *National Enter. Inc. v. Mellon Fin. Ser. Corp.*, 847 F.2d 251 (5th Cir. 1988). There, the creditors of a corporation which was the victim of an act of racketeering activity were held to lack standing to sue the perpetrator. The *National Enterprises* court illustrated what could happen if the "direct injury" requirement of civil RICO standing was relaxed. Taxpayers only indirectly injured by a fraud perpetrated on a county could claim standing; an insured could claim standing to sue an insurance agent for causing his insurance company to become bankrupt; and union members would have standing to sue those who committed acts of racketeering activity against the union. In fact, courts have determined in each of the foregoing

[3] The *Rylewicz* court cites decisions in the Fifth, Eleventh, First, Second and Sixth Circuit to the same effect. *See Rylewicz*, 888 F.2d at 1179.

contexts that the plaintiff lacks standing. *See Id.; see also Warren v. Manufacturers Nat'l Bank of Detroit*, 759 F.2d 542, 545 (6th Cir. 1985) ("Whether RICO should or should not be interpreted to 'federalize' common law fraud is an issue distinct from whether it should be interpreted to materially expand the standing requirement applicable to such claims."); *Flynn v. Merrick*, 881 F.2d 446 (7th Cir. 1989) (shareholder and debentureholder did not have standing under civil RICO to sue for an injury suffered by the corporation in which they were shareholders and debentureholders).

In *Wooten v. Loshbough*, 738 F.Supp. 314 (N.D. Ind. 1990), the court applied the same RICO standing principles discussed above. The plaintiff in *Wooten* was a judgment creditor of a press machine manufacturer as a result of obtaining a judgment against the manufacturer arising from a personal injury sustained by plaintiff. The plaintiff sued a third party for perpetrating racketeering activity against the manufacturer with respect to which plaintiff was a judgment creditor. The court ruled that the plaintiff had no standing to sue under civil RICO for injury suffered by the manufacturer, which caused the manufacturer to divert funds which rendered the manufacturer unable to satisfy the plaintiff's judgment.

The plaintiff's injury, reasoned the court, flowed only indirectly from the injury sustained by the manufacturing corporation and was therefore not assertable by the plaintiff, merely one of the victim's creditors. The perpetrators of racketeering activity plundered the corporation, not plaintiff, and plaintiff's inability to enforce her judgment against the corporation was an indirect result of activities undertaken against the corporation. *Id.* at 317. *See also Grafman v. Century Broadcasting Corp.*, 727 F. Supp. 432 (N.D. Ill. 1989) (standing under civil RICO denied to a

shareholder and director who sought to sue for racketeering activity directed against the corporation).

In the context of a sale of securities, of necessity and by definition of "sale," the parties directly involved in the transaction are the purchaser and seller. The effects of each party's conduct impacts the other directly. A fraud committed by either in connection with the sale directly damages the other, whether because the seller's fraud has increased the price the buyer pays or the buyer's fraud has wrongfully decreased the proceeds of sale to the seller. Anyone else impacted by fraud of the buyer or seller, such as a prospective buyer or seller who chose not to buy or sell, or a person who arrives on the scene subsequent to the fraud and claims economic harm, such as SIPC here, is injured indirectly, not directly, by the fraudulent conduct.

That the plaintiff must demonstrate a direct injury in order to acquire standing when fraud in the sale of securities is the predicate act of racketeering activity was established by the Fourth Circuit in *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987). The Fourth Circuit ruled that a corporation that was neither a purchaser nor seller of its own securities did not have civil RICO standing to sue two individuals who prepared an allegedly misleading securities offering prospectus for the corporation. The *International Data Bank* court noted the necessity of limiting civil RICO standing to persons who have suffered a direct harm and precluding standing to those who have suffered indirect harm. Otherwise, if a corporation were harmed by a securities fraud, the corporation's customers, employers or contractors could sue and anyone connected with the victim of racketeering

activity in any capacity could allege some indirect harm, a result not intended under civil RICO. *Id.* at 153.

The soundness of the decision in *International Data Bank* is evident here. SIPC was neither a purchaser nor seller of any of the securities which were allegedly manipulated by Holmes and other defendants. Nor was SIPC the securities brokerage firm allegedly injured by the securities manipulation. Instead, SIPC is an entity whose statutory duties required it to arrive after the fact and pay money to the brokerage firms' customers, most of whom were themselves neither purchasers nor sellers of the allegedly manipulated securities.[4] SIPC was not

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[4] SIPA contains a concise framework, administered by SIPC, for the reimbursement of customers of failed brokerage houses. SIPC is constrained by the requirements of SIPA to reimburse only those customers who have net equity claims against the failed brokerage firm. A brokerage firm customer may have a net equity claim, reimbursable by SIPC, that had nothing to do with the alleged manipulation of the target securities at issue here. Customers of the failed brokerage firms who purchased target securities shared in the fund of customer property set up under SIPA (primarily assets of the defunct brokerage firms belonging to or held in trust for the accounts of customers), and received reimbursement from SIPC to the extent that the fund of customer property did not satisfy the customers' net equity in the customers' account with the defunct brokerage firm. Such customers could and did maintain their own actions against the alleged manipulators of the target securities based on Rule 10b-5 or RICO.

However, certain customers did not purchase the target securities, but also shared in the fund of customer property and received a reimbursement from SIPC. These were customers whose net equity account claims were not satisfied by the customer fund (and who did not have a Rule 10b-5 action

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directly injured by the fraudulent conduct which it claims constituted the racketeering activity. The direct victims of the alleged racketeering activity were open market purchasers and sellers of the allegedly manipulated securities and the failed securities brokerage firms which had a large inventory of the manipulated securities and whose financial condition was adversely affected by the manipulations. SIPC was not even a successor entity to the brokerage firms, but rather a mandatory post-failure statutory contributor to alleviate certain remnants of their demise. SIPC's position is akin to that of a shareholder or creditor of a victim of the fraud who invested capital or extended credit after the fraud was completed, and who was not itself directly injured by the fraud.

The *International Data Bank* court made clear that a person who was neither a purchaser nor a seller of securities should not be viewed as a matter of policy as having

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against Holmes and others because they were not purchasers or sellers of securities of the alleged target securities). SIPC succeeded to their rights by subrogation. These customers had no automatic standing to sue Holmes under RICO to recover for failure of the brokerage houses to satisfy their net equity claims. Yet SIPC has assumed that because of its subrogation to the claims of all customers whose claims against the brokerage firms it has reimbursed, SIPC automatically may sue and recover against Holmes on the basis of such subrogation regardless of whether the reimbursed customers themselves had standing to assert a RICO claim.

To construe RICO standing that broadly would make Holmes a virtual insurer of loss of the customers of the failed brokerage houses. Liability under RICO or otherwise does not extend so far. If the securities in question for which SIPC reimbursed a customer were not manipulated securities, such securities would have had nothing to do with the alleged fraud except for the happenstance that they were traded at the same failed brokerage house.

been directly injured by a fraud in a sale of securities. *See International Data Bank*, 812 F.2d at 154. On the facts of the instant case, where purchasers and sellers of the allegedly manipulated securities and the securities brokerage firms were the direct victims of the disputed conduct, SIPC was far removed from the alleged securities fraud and arrived on the scene after the consequences of the fraudulent activity were fully at rest. SIPC was not directly damaged by the conduct at issue. The wisdom of *International Data Bank* is particularly appropriate here and commends itself to deny SIPC standing under civil RICO.

III.

A PERSON SUCH AS SIPC HERE, WHO ALLEGES FRAUD IN THE SALE OF SECURITIES AS A RICO PREDICATE ACT, BUT WHO WAS NEITHER A PURCHASER NOR SELLER OF SECURITIES, LACKS CIVIL RICO STANDING UNDER §1964(c) TO CLAIM TO HAVE BEEN INJURED "BY REASON OF" THE FRAUD.

Under civil RICO, the concepts of standing and causation are blended as a result of §1964 which grants standing to "any person . . . injured . . . by reason of . . . [racketeering activity]. . . . "

The words "by reason of" in RICO §1964(c) have been construed as requiring a causal connection between the plaintiff's injury and the predicate act of racketeering activity. *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985). It is entirely appropriate that this causation requirement appear in the general civil RICO standing section, §1964(c). Indeed, the phrase "by reason of," mandating a causal connection between the racketeering activity and the injury complained of, serves the same function as the phrase "in connection with" under Exchange Act §10(b) and Rule 10b-5, requiring a causal

connection between the claim and the fraud involving the purchase or sale of securities.[5]

Under the Exchange Act, a person who is neither a purchaser nor seller of securities does not have a sufficient causal connection to the fraud in the sale of securities to have standing to complain. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952). Similarly, under civil RICO, when fraud in the sale of securities is the predicate act of racketeering activity, a person who is neither a purchaser nor seller of securities is not injured "by reason of" the fraud in the sale of securities.

In the landmark *Birnbaum* decision, a shareholder of Newport Steel Corp., who was neither a purchaser nor seller of securities, complained of the sale of securities of Newport Steel by defendants to each other. The plaintiff claimed that the sale of a control block of stock, at a premium above market value, enabled the purchaser to obtain a captive source of supply for steel, but damaged the corporation. Plaintiff contended that standing under Rule 10b-5 should not be limited to purchasers or sellers of securities, because Rule 10b-5 proscribes "frauds upon any person" (not unlike the phrase "any person" in RICO §1964(c)). The plaintiff in *Birnbaum* further argued that if the intention of the drafters of Rule 10b-5 was to deal just with purchases or sales of securities, the Rule would not have used the words "in connection with."

The court in *Birnbaum* ruled, without doubting that Congress was motivated by a broad purpose to protect investors from exploitation by insiders (much like

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[5] *See e.g., Ohashi v. Verit Industries*, 536 F.2d 849, 852-3 (9th Cir. 1976), *cert. denied*, 429 U.S. 1004 (1976).

Congress was motivated by a broad purpose in passing RICO), that the precise question was whether Exchange Act §10(b) the Rule 10b-5 were the means chosen to further that broad end. The court noted that Rule 10b-5 may have been somewhat loosely drawn (not unlike comments which have been made by this Court with respect to RICO).[6] Nevertheless, the words "in connection with" in Rule 10b-5 did not invite open-ended remote causal connection and speculation. Accordingly, the court limited standing under Rule 10b-5 to purchasers or sellers of securities. *Birnbaum*, 193 F.2d at 464.

In *Craig v. First Am. Capital Resources, Inc.*, 740 F. Supp. 530 (N.D. Ill. 1990), the district court explicitly described the function of the words "in connection with" in Rule 10b-5, a subject which was implicitly dealt with by the *Birnbaum* court. The court in *Craig* stated, "[t]o satisfy the 'in connection with' language of §10(b) and Rule 10b-5, a plaintiff must show a causal connection between his decision to buy or sell securities and the defendant's fraudulent conduct." *Id.* at 535.

The requirement that there be a sufficient causal connection between the harm complained of and the plaintiff's injury in order for the plaintiff to have standing, which was established under the Exchange Act and Rule 10b-5 by *Birnbaum* and *Craig* among others, is similar to the requirement under civil RICO that the plaintiff must show a causal connection between the injury complained of and the predicate act of racketeering activity. *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496-7 (1985). When the predicate act of racketeering activity is "fraud in the sale of securities," the existing body of law pertaining to standing with respect to fraud in the sale of securities is

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[6] *See H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 106 L.Ed.2d 195, 214 (1989).

readily available to evaluate standing and should be utilized. Dealing with the merits of causation may generally be a question of fact for the trier of fact, but where the law has made a clear determination that it is inappropriate for a person lacking causal connection in certain respects to have standing to sue, the question of sufficient causal connection should become one of law for the court to resolve in the context of standing, rather than one of fact for the trier of fact to resolve.

In *Wooten v. Loshbough*, 738 F. Supp. 314 (N.D. Ill. 1990), plaintiff, a judgment creditor of the corporate victim of racketeering activity, was denied standing. Defendants argued that there was an insufficient causal connection between the plaintiff's injury and the racketeering activity. The district court, citing *Sedima*, stated that "causation is a requirement of standing" under RICO, and an extremely attenuated causal connection will not survive a standing attack under RICO. *Id.* at 317. In *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987), the Fourth Circuit noted that the problems of proof that lead to limiting standing under the Exchange Act to purchasers and sellers apply also in the civil RICO context where fraud in the sale of securities constitutes the alleged predicate act of racketeering activity. If nonsellers and nonbuyers were permitted to complain about a nonevent, namely their failure to purchase or sell securities, the problems of proof with respect to causation would be endless. By limiting the class of plaintiffs at least to those who actually dealt in the securities, a rational outer limit is set on standing. Otherwise, participants in securities markets could await development without risk and then assert their claims or, as with SIPC, arrive on the scene after completed events that did not directly affect them and claim the right to sue. *See Id.* at 153.

Application of the purchaser-seller standing requirement is particularly appropriate here. There actually were purchasers and sellers of the allegedly manipulated securities, none of whom was SIPC. The purchasers and sellers commenced a separate class action which was resolved by settlement. SIPC was not affected by the fraud at the time the alleged fraud was occuring. SIPC arrived on the scene after the alleged acts of racketeering activity were completed. SIPC did not appear until after the brokerage firms' failure to meet required net capital standards had already occurred. SIPC thereafter made payments to brokerage firm customers with account balances entitling them to compensation from SIPC, whether or not the brokerage firm customers were purchasers or sellers in any transactions involving the allegedly manipulated securities.[7] SIPC made these payments not because SIPC was induced to pay by fraud, but because SIPC was mandated to pay by statute. The causal connection between the payments made by SIPC and the manipulation of securities is speculative and tenuous at best, if it exists at all.

If SIPC has standing to sue for these alleged manipulations, causation requirements will have run amuck. The causal connection between the harm complained of, namely the alleged manipulation of the six securities, and injury to SIPC is too attenuated to be legally cognizable and is best dealt with in the context of standing by ruling

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[7] SIPC, of course, was required to advance funds to reimburse *any* non-broker/dealer and non-bank customer of the brokerage firms, unrelated to the management of the brokerage firms, who had a net equity claim against the brokerage firms not satisfied by the customer fund set up under the requirements of SIPA. *See* SIPA §78fff-3. Many of these customers were purchasers or sellers of securities other than those allegedly manipulated.

that SIPC, as a nonpurchaser and nonseller of the manipulated securities, has no standing to sue on account of the alleged manipulation.

The rejection of SIPC's standing, as an entity which has not been injured under civil RICO "by reason of" the predicate act of fraud in the sale of securities, is entirely consistent with and mandated by well-settled principles of standing in securities law and well reasoned judicial decisions involving RICO.

IV.

ON ITS FACE, RICO §1964(c) INCORPORATES BY REFERENCE STANDING REQUIREMENTS UNDER THE EXCHANGE ACT WHEN IT INCORPORATES BY REFERENCE THE BODY OF LAW PERTAINING TO FRAUD IN THE SALE OF SECURITIES.

RICO §1964(c) provides in substance and effect that when a person is injured in his business or property by reason of an act of racketeering activity under §1962, as defined in §1961, such person has standing to sue. "Racketeering activity" is defined as, among other matters, an "offense involving . . . fraud in the sale of securities" (RICO §1961(1)(D)). Viewing §§1964(c), 1962 and 1961(1)(D) together, when "fraud in the sale of securities" is alleged as the predicate act of racketeering activity, for all intents and purposes, §1964(c) should be read as though it provides in relevant part that "a person who is injured in his business or property by reason of fraud in the sale of securities has standing to sue." Viewed in this light, it is apparent that in operation and effect, civil RICO does no more than incorporate by reference and

expressly refer to the body of federal securities law pertaining to "fraud in the sale of securities."[8]

This view is unaffected by the recognition that the complete predicate act is described in RICO §1961(1)(D) as an "offense involving fraud in the sale of securities." Although the term "offense" generally denotes criminal conduct as to which there is no purchaser-seller standing requirement when a criminal action is commenced by the government, the issue here is construction of a civil provision, §1964(c) in actions commenced by private parties.

Even if criminal offenses in securities law prosecuted by the government have no standing requirements and are not subject to the purchaser-seller rule, that does not resolve the interpretation of standing requirements under §1964(c). RICO §1964(c) is part of a group of statutory provisions within §1964, which together are entitled "Civil Remedies." Interpretation of standing under §1964 (c) is governed by civil, not criminal, law rules. This Court has intimated, without resolving, that in setting the burden of proof under §1964, the predicate criminal offenses need be proven only by the civil standard, preponderance of the evidence, not the criminal standard,

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[8] *Cf.* Blakey, *Foreward* to *Law and the Continuing Enterprise: Perspectives on RICO*, 65 Notre Dame L. Rev. 873, 876 (1990) (" . . . RICO does not displace other bodies of law, federal or state . . . The issue was not whether the 1970 Act should apply to the conduct prohibited by its predicate offenses, but whether it should preempt other laws. Congress expressly saved 'provision[s] of Federal, State, or other law imposing criminal penalties or affording civil remedies in addition to those provided for' in RICO" (citing 84 Stat. 947 (1970)).

beyond a reasonable doubt. *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 490-1 (1985). Also, civil RICO §1964 provides a civil remedy in federal court for predicate acts under §1961(1)(A), which under criminal law would be prosecutable in state court only. Courts have generally held that rules of civil law, not criminal law, are applicable to construction of civil RICO §1964(c), even though it incorporates criminal predicate acts. *See Liquid Air Corp. v. Rogers*, 834 F.2d 1297, 1302 (7th Cir. 1987) (and cases collected there). Questions of standing should be resolved no differently. It cannot be fairly said that civil RICO has no standing requirements, merely because it refers to criminal predicate acts, which themselves grant standing only to governmental prosecuting authorities. If one were to argue that civil RICO limits standing to the limits of the criminal predicate acts, that would limit civil RICO standing to government entities, which would contradict the plain wording of §1964(c) granting standing on certain conditions to "any person." Alternatively, the argument that civil RICO grants unlimited standing to "any person" free of any and all restrictions would effectively read out of §1964 the requirements of direct injury contained in the phrase "injured in his business or property" and the causation requirements contained in the phrase "by reason of."

In construing RICO §1964(c) where a "fraud in the sale of securities" is alleged, the majority of courts utilize the already existing body of decisional law under Rule 10b-5. If one of the traditional elements of fraud in a sale of securities as developed in that body of law is missing, such as a duty owed to the seller, there would be no "fraud in the sale of securities" to constitute a predicate act of racketeering activity. In *Moss v. Morgan Stanley, Inc.*,

719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984), the Second Circuit, relying on precedent decided under Rule 10b-5, rather than treating the question as one of first impression under a newly created civil RICO statutory standard, determined that when a shareholder, who unwittingly sold securities of a target company on the open market, was not owed a duty of disclosure under securities law by a purchaser, there was no violation of Rule 10b-5. *Id.* at 15. Accordingly, under civil RICO there was no predicate act of "fraud in the sale of securities" to provide the basis for a civil RICO claim. Once the securities fraud claim was dismissed, the existence of any "racketeering activity" was undercut. In *Chief Consolidated Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191 (D.C. Utah 1989), the district court concluded that all settled elements of a Rule 10b-5 claim, scienter, reliance, materiality and causation, are incorporated in the predicate civil RICO offense of fraud in the sale of securities. Accordingly, the court concluded "that private persons have standing to bring RICO claims based on securities violations under Rule 10b-5 only if they are purchasers or sellers of securities. The arguments articulated in [*International Data Bank*] are persuasive." *Id.* at 1194.

It would be hard to imagine a viable claim of fraud in the sale of securities as a predicate act of racketeering activity if there were no security, no duty, or no causation. Since incorporation by reference into the term."racketeering activity" of "fraud in the sale of securities" carries with it all of the developed body of law as to the elements of fraud in the sale of securities, there is no reason to leave behind the settled body of law pertaining to standing.

Whether standing is considered an element of the underlying offense involving fraud in the sale of securities, or whether the separately developed notion of standing contained in §1964(c) controls, the result is the same where fraud in the sale of securities is relied upon as "racketeering activity." Standing requirements applicable to securities fraud should apply under civil RICO.

The Fourth Circuit in *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987) stated that whether "fraud in the sale of securities" incorporates by reference the standing provisions of securities fraud statutes or whether it limits by its own force the RICO standing to actual purchasers and sellers, either way standing is limited accordingly. *Id.* at 152. The court in *International Data Bank* also noted that all elements of a Rule 10b-5 claim are appropriately incorporated in the predicate offense and it is difficult to conclude that Congress would have insisted on an unexpressed statutory inconsistency, in treating standing requirements differently than other elements of §10(b).

V.

THE RELATIVELY NARROW DEFINITION OF "RACKETEERING ACTIVITY" CONTAINED IN RICO §1961(1)(D) CONSISTING OF AN "OFFENSE INVOLVING FRAUD IN THE SALE OF SECURITIES" REFLECTS AN INTENTION TO PRESERVE APPROPRIATE STANDING LIMITATIONS.

Among all of the definitions of "racketeering activity," the predicate act of an "offense involving fraud in the sale of securities," is the most narrowly defined of the approximately 36 predicate acts listed at RICO §1961(1).

Every other predicate act consists of either every conceivable offense without limitation under a designated statute (*e.g.*, 18 U.S.C.A. §659, relating to theft from interstate shipment) or even more broadly, every conceivable variety and degree of a particular designated category of crime which may be punishable under more than one provision of state law (*e.g.*, murder, kidnapping and arson). If a predicate act of comparable breadth and scope were intended with respect to securities law, the provision pertaining to securities laws could have established as an act of "racketeering activity" any offense under Section 32 of the Exchange Act (15 U.S.C. §77ff), or Section 24 of the 1933 Securities Act (15 U.S C. §77x), which render criminal any wilful violation of the Exchange Act and the Securities Act, respectively. Such a broad definition of securities related crimes would have included not only fraud in the sale of securities, but also proxy rule violations, tender offer violations, and any of the other myriad breaches of duties and responsibilities which do not have purchaser-seller limitations and which, if committed wilfully, may be punishable as crimes under the Exchange Act and the Securities Act. A broader approach was taken in defining the predicate act of bankruptcy fraud where the predicate offense is defined as "any offense involving fraud connected with a case under title 11." RICO §1961(1)(D). *See International Data Bank*, 812 F.2d 149, 152 (4th Cir. 1987).

The relatively narrow and circumscribed statement of the predicate offense with respect to securities, limited to an offense involving fraud in the sale of securities, is unique among the listing of predicate acts of racketeering activity. The narrow statement of the offense reflects an

intention to carve out less than all offenses which may be punishable under a particular statutory section or group of statutory sections. The words "sale of" which modify "fraud" and "securities" constitute a narrowing of the predicate offense. If the modifying words "sale of" had been omitted, any type of securities fraud would have been sufficient as a predicate offense for "racketeering activity." That the predicate offense so narrowly defined actually means what it appears to say was adjudicated by the very Ninth Circuit whose opinion below is here at issue. In *First Pacific Bancorp, Inc. v. Bro*, 847 F.2d 542 (9th Cir. 1988), the Ninth Circuit ruled that failure to comply with a provision of the Exchange Act relating to proxy solicitations, not involving the sale of securities, did not satisfy the requirements of a predicate act of fraud in the sale of securities, so that the civil RICO provisions "have no application. . . . " *Id.* at 546.

This Court has elsewhere recognized that the expansive use of civil RICO is primarily the result of breadth of the predicate offenses. *See H.J., Inc., v. Northwestern Bell Telephone Company*, 492 U.S. 229 (1989). It follows conversely that where the predicate offenses are narrowly circumscribed, as with fraud in the sale of securities, an expansive use of civil RICO is not warranted.

A narrow statement of the scope of the predicate offense suggests that a standing requirement which was judicially developed to limit and sensibly regulate the category of persons entitled to complain of the conduct should not be disregarded, particularly when the offense serves as a predicate act for other and further remedies, such as those of civil RICO.

VI.

IN ADOPTING RICO, CONGRESS DID NOT INTEND TO OVERRULE, ELIMINATE OR EMASCULATE THE PURCHASER-SELLER STANDING REQUIREMENT PERTAINING TO FRAUD IN THE SALE OF SECURITIES.

Generally, when Congress intends to deal with or define a crime or a duty which shall not be breached, Congress is specific. Indeed, the *Birnbaum* court noted that when Congress intended to prevent breaches of fiduciary duty, it was specific. *Birnbaum*, 193 F.2d at 464. A congressional intent to make fundamental changes in a regulatory structure such as that abolishing the purchaser or seller standing requirement in securities fraud should not be lightly inferred. The dissent in *Sedima*, written by Justice Marshall, and joined by Justices Brennan, Blackmun and Powell, stated that one should "not lightly infer a congressional intent" to make "fundamental changes." *Sedima*, 473 U.S. at 501. The *Sedima* dissent further noted that RICO should not be construed to circumvent or trivialize the Exchange Act and the settled law which has developed under the Exchange Act. *See Id.* at 506 (dissenting opinion). Congress did not intend to bring about a dramatic change in commercial litigation when it adopted RICO. Civil RICO was not intended to displace or supersede other federal remedial schemes. *Id.*

Had a principle of limitation of standing so well grounded, so well settled in its implications, as the purchaser-seller requirement been intended to be overruled by RICO, at the very least Congress would have used clear words to do so. While no one will quarrel with

Justice White's statement in *United States v. Turkette*, 452 U.S. 576 (1981), that there is no errorless test for recognizing plain or unambiguous language, particularly in RICO[9], Congress used no language at all to address the question of whether it intended to abolish the purchaser-seller standing limitation settled in securities laws. The question arises as to what follows from Congress' failure to address the purchaser-seller standing rule directly. An argument could be made that Congress' failure to incorporate specifically the purchaser-seller requirement means that Congress did not intend to adopt it. A more persuasive argument is that a statute properly drawn does not address specific cases, as that is the work of a court. A statute sets forth the general concepts by which specific cases are resolved. That was done in §1964(c). By incorporation by reference, use of the "injury" language and use of the phrase "by reason of," Congress has provided the concepts and standards by which the appropriateness of including the purchaser-seller standing rule can be evaluated.

A brief review of the legislative history of RICO is instructive in this respect. At the time RICO passed the Senate, Section 1964(c) in its current form did not exist. *See* S.Rep. No. 617, 91st Cong. 1st Sess. at 24 (1969). Section 1964(c) arose for the first time after the Senate bill had been passed and while the House was considering RICO. *See* Bridges, *Private RICO Litigation Based Upon "Fraud In The Sale Of Securities,"* 18 Ga. L. Rev. 43, 55 and n.83 (1983), [hereinafter "Bridges"].

To the extent the Senate considered other bodies of law at all in relation to RICO, it referred to antitrust law and sought to utilize antitrust remedies as a model for

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[9] *See United States v. Turkette*, 452 U.S. 576, 580 (1981).

interpreting RICO. The Senate did not view antitrust law remedies as something to be cast aside in the wake of RICO. S. Rep. No. 617, 91st Cong. 1st Sess. at 81 (1969). The concept of deferring to and applying other bodies of law without mentioning any criticism of the Exchange Act hardly establishes a basis for concluding that Congress intended to overrule a settled standing principle of securities law. There is no legislative history in the House deliberations with respect to RICO which suggest anything different or any dissatisfaction with the body of securities law including standing limitations which had existed at the time RICO was passed. The Senate noted in its report that the civil remedies under RICO sought economic, not punitive goals. *See Id.*

In *International Data Bank,* the Fourth Circuit noted that Congress wrote RICO against a backdrop of 40 years of federal securities law and that if Congress had intended to overturn the purchaser-seller holding of *Blue Chip Stamps*, "it surely would have done so in a more explicit way." 812 F.2d at 152. Other Rule 10b-5 requirements such as scienter, reliance, materiality and causation are doubtlessly incorporated in the predicate offense. It is difficult to discern why Congress would then have insisted on statutory inconsistency solely with respect to the showing of "injury" required for standing. *Id.* The *International Data Bank* court doubted that Congress meant to overturn *Birnbaum* when it listed securities fraud among numerous qther predicate offenses. The same court thought that with civil RICO, Congress meant to expand the remedies (*e.g.* treble damages and attorneys' fees) rather than to overturn summarily settled principles of standing. *See Id.* at 152-3.

There is no portion of the legislative history of RICO which expressly addresses the issue of the status of the then existing body of securities law and suggests in any manner that Congress was critical of it or desired to change it. Indeed, since the civil RICO provision of Section 1964(c) did not even exist in its present form when approved by the Senate, there could have been no such consideration before the Senate. Congressional silence is an insufficient basis for inferring a dramatic change in the historical structure of commercial litigation in the area of securities law. While RICO is to be construed broadly, it is not to be construed inconsistently, at variance with its legislative history, or contrary to its plain meaning. There is nothing in the mandate of broad construction which suggests a congressional purpose of overturning the well-settled and widely accepted principle of purchaser-seller standing in securities law.

VII.

SOUND AND APPROPRIATE JUDICIAL POLICY REQUIRE THAT WELL-SETTLED AND WIDELY ACCEPTED PRINCIPLES OF STANDING UNDER THE EXCHANGE ACT APPLY UNDER RICO WHEN FRAUD IN THE SALE OF SECURITIES IS ALLEGED AS A PREDICATE ACT OF "RACKETEERING ACTIVITY."

A. It is Appropriate to Consider Matters of Judicial Policy.

Where the statutory language is silent, gray, or unclear, it is proper to consult practical considerations of judicial policy. The court in *International Data Bank* stated that although the RICO right of action is express and the

Rule 10b-5 remedy is implied, many elements of the RICO claim (presumably including standing) have not been clearly legislated. *International Data Bank*, 812 F.2d at 153. As to those elements, the court thought it proper and prudent to consult the practical considerations of *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), the landmark decision which established the requirement that a plaintiff be a purchaser or seller of securities in order to have standing to present a claim for securities fraud under the Exchange Act. *See Id.*

This Court has recognized that "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors" and this Court shared "the doubts of the Court of Appeals [for the Second Circuit] about this increasing divergence." *Sedima*, 473 U.S. 479, 500 (1985).

The dissent in *Sedima* noted that it is particularly important to construe civil RICO carefully because in civil RICO, unlike criminal RICO, the responsible use of prosecutorial discretion as a restraining influence is absent. *See Sedima*, 473 U.S. at 504-505 (Marshall, Brennan, Blackmun and Powell JJ., dissenting).

The essential injustice in the ruling on standing of the court below is that it permits a person who would have no standing under the Exchange Act to obtain an even more extreme remedy, treble damages and attorneys' fees, under RICO for the very same conduct. The effect of such a holding is to enable persons who would not be entitled to standing under the Exchange Act to circumvent the Exchange Act and thereby trivialize and emasculate the carefully crafted protections which a body of

judicial decisions have built into the law over 40 years of development. The dissent in *Sedima* recognized under the circumstances there present, such a result should not be permitted. Here, where the issue is squarely before the Court, the point of view which was shared by four justices in the *Sedima* dissent with respect to a matter not there required to be passed upon by the Court, now merits adoption by a majority of the Court.[9]

In its recent substantive pronouncement on RICO, this Court noted that in *Sedima*, "this Court rejected a restrictive interpretation of §1964(c). . . . In doing so, we acknowledged concern in some quarters over civil RICO's use against 'legitimate' businesses,. . . . " *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 106 L.Ed.2d 195, 205 (1989).

Under these circumstances, with an absence of express congressional intent and an apparent dispute about the meaning of the statutory language, as well as concern over possible misuse and abuse of civil RICO, it is appropriate for this Court to consult with judicial policy considerations in resolving the question as to which certiorari has been granted.

B. The Policy Considerations Which Led to Adoption of the Purchaser-Seller Standing Requirement Apply With Even More Force When Securities Fraud is Alleged as a Predicate Act of "Racketeering Activity."

In ruling that a person must be a purchaser or seller of securities to have standing to complain of fraud "in

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[9] *See Sedima*, 473 U.S. at 505 (Marshall, Brennan, Blackmun and Powell JJ., dissenting).

connection with" the sale of securities under the Exchange Act, the Court in *Blue Chip Stamps*, 421 U.S. 723 (1975), cited *Birnbaum*, 193 F.2d 461, a landmark opinion decided by the Second Circuit. After determining that the intent of Congress could not be divined with respect to interpretations of Rule 10b-5 under the Exchange Act and noting that the Court was dealing with "a judicial oak which has grown from little more than a legislative acorn," a development unforeseen by Congress, the *Blue Chip Stamps* Court stated, "It is therefore proper that we consider, in addition to the factors already discussed, what may be described as policy considerations when we come to flesh out the portion of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance." *Blue Chip Stamps*, 421 U.S. at 736-737.

The Court in *Blue Chip Stamps* noted, "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Id.* at 739. In securities law, even a complaint which by objective standards has very little chance of success at trial has a settlement value out of proportion to the prospects for success at trail, so long as the plaintiff can prevent the suit from being dismissed by motion. *Id.* The Court in *Blue Chip Stamps* also noted the potential for abuse of discovery and that, in connection with Exchange Act litigation, it is easy to allege a case but hard to prove it, and there is a great risk of strike suits. *Id.* at 740-42. A standing rule limiting the class of plaintiffs to purchasers and sellers separates out prospective plaintiffs who are more likely to be believed and are less

likely to bring strike suits. An opening of the gates of standing would have the effect of throwing "open to the trier of fact many rather hazy issues of historical fact. . . ." *Id.* at 743. In sum, this Court acknowledged its "concern that . . . broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good." *Id.* at 748. The concurring opinion went even further and stated, "A rule allowing this type of open-ended litigation [free of standing limitation] would itself be an invitation to fraud." *Id.* at 761 (Powell, Stewart and Marshall, JJ., concurring).

The very considerations expressed in *Blue Chip Stamps* with respect to limiting standing under Rule 10b-5 apply with equal if not greater force under RICO. Litigation under civil RICO is inherently vexatious and complaints with little chance of success have a disproportionate settlement value. In this case, which has been pending for almost eight years, it is evident, from an examination of the docket, which reflects that the case has not yet gone to trial, and has been appealed to the Ninth Circuit three times, that attorneys' fees on each side have been massive. Attorneys' fees alone have already far exceeded the amount paid in settlement to the class representatives of the purchasers and sellers of the allegedly manipulated securities, in the consolidated companion class action. Holmes appears to be a rare civil RICO defendant who is willing to fight the RICO charges at great expense. The massive and costly scope of this battle only serves as a deterrent to other defendants, and only serves to illustrate the reasons for the premium generally placed on settling civil RICO cases at irrationally disproportionate amounts.

Under RICO, as under the Exchange Act, broadening standing would unduly burden the judicial system when the questions raised by standing can best be resolved at the outset by the court. Under RICO as under the Exchange Act, broadening standards would result in more harm than good and would itself be an invitation of fraud. *See Blue Chip Stamps*, 421 U.S. at 761 (Powell, Stewart and Marshall, JJ., concurring). Civil RICO, like the Exchange Act, has been used for extortive purposes, as was recognized by the dissent in *Sedima*. *See Sedima*, 473 U.S. at 365 (Marshall, Brennan, Blackmun and Powell, JJ., dissenting).

C. Disregarding The Purchaser-Seller Standing Limitation Under RICO Would Unjustly Emasculate and Trivialize a Well-Settled and Widely Accepted Principle of the Law of Securities Fraud.

The obvious practical consequence of the expanded standing sought by SIPC here is that a person who lacks standing to sue for fraud in the sale of securities under the Exchange Act could sue for the very same conduct under RICO and obtain an even more extreme remedy. To permit such a result would in effect eliminate the well-settled and widely accepted standing requirement under the Exchange Act, since persons who could not satisfy it would simply sue under RICO and circumvent the requirement.

The effect of such a rule of open standing would be to turn well-settled and widely accepted principles of commercial litigation on their head, without any mandate

to do so from Congress or any sound reason in judicial policy to accomplish such a result. There is no reason to eliminate the purchaser-seller standing requirement from the body of settled commercial litigation principles and it should not be done. If a person is unable to state a claim under the Exchange Act for fraud in the sale of securities, for whatever reason, whether for lack of an element of the claim or for lack of standing to assert the claim, such a claim would be dismissed if maintained in a separate action under the Exchange Act. A claim which is capable of being dismissed should not suffice as a predicate act to invoke the additional remedies of civil RICO.

In *Brannan v. Eisenstein*, 804 F.2d 1041 (8th Cir. 1986), the Eighth Circuit dismissed a claim under Rule 10b-5 for lack of standing, finding that plaintiffs were neither purchasers nor sellers of securities, stating:

> Since we have already found that the directors' state and federal securities fraud claims . . . were properly dismissed, the directors may not rely upon the same conduct as the basis of any securities fraud that may constitute racketeering activity.

Id. at 1046.

The Second Circuit reached a similar result, ruling that where a complaint failed to allege a fraud with respect to a securities' sale, there was no predicate securities fraud to support a claim of racketeering activity. *See Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983).

VIII.

THE DECISION BELOW SHOULD BE REVERSED AND THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS BY ADOPTING THE VIEWS EXPRESSED BY THE FOURTH CIRCUIT ON RICO STANDING.

Based upon the foregoing, it is apparent that the decision below was deficient in numerous respects. In the first instance, the court below based its ruling on the conclusion that, "[o]n its face, the RICO statute has no purchaser-seller standing requirement." *Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461, 1466 (1990). This conclusion is baldly stated without adequate support. The court below did not consider the argument that the very words in RICO §1964(c) that "any person injured in his business or property" require demonstrating a direct injury, which a non-purchaser or non-seller of securities does not have. The court's statement also ignores the requirement contained plainly in §1964(c) that for standing to exist, the injury must be "by reason of" a fraud in the sale of securities, requiring a causal connection between the sale of securities and the damage. A non-purchaser or non-seller cannot show the requisite causal connection.

The decision below also ignores the argument that the definition of racketeering activity as "fraud in the sale of securities" incorporates by reference the developed standing requirements applicable to fraud in the sale of securities. If there are sound reasons for rejecting these views (and petitioner Holmes does not believe there are), they were not identified or discussed by the court below. The decision below on its face offers insufficient consideration of the statutory text of RICO.

In addition, the court below relied upon the idea that RICO contains an express remedy while the Exchange Act and Rule 10b-5 involve remedies implied by courts and that it is more appropriate to limit implied remedies than to limit express remedies. *Id.* The problem with this view, however, is that it does not consider the argument that the standing limitation is inherent in the civil RICO remedy as expressed by Congress in §1964(c). The express-implied remedy distinction need not be reached in order to ascertain the appropriate standing requirement for RICO. It is not the mere statement of an express remedy that governs its interpretation but rather all of the circumstances, including congressional history, plain meaning of the language of the statute and, where appropriate as here, policy considerations.

Finally, the court below states as a basis for its decision the widely accepted and undisputed view that "RICO is to be read broadly." *Id.* Merely acknowledging that RICO should be read broadly, however, is not a sufficient basis for resolving the question before this Court. When faced with an analogous question construing the Exchange Act, the *Birnbaum* court stated that it did not doubt that Congress was motivated by a broad purpose to protect investors. Nevertheless, the precise question then before the court had to do with the means chosen to further that end. Merely acknowledging Congress' broad purpose did not provide a basis for resolving the question before the court with regard to standing. *See Birnbaum*, 193 F.2d at 464.

The court below did not deal with, much less try to reconcile, the conflict between judicial circuits with respect to the question presented here. No mention was

made by the court below of the well reasoned contrary decision of the Fourth Circuit in *International Data Bank,* which was expressly cited to the court below by Holmes. In *Warner v. Alexander, Grant and Co.,* 828 F.2d 1528 (11th Cir., 1987), the Eleventh Circuit stated in passing:

> "The federal RICO statute has no requirement analogous to the 'purchase or sale' requirement of the federal securities laws." *Id.* at 1530.

The *Warner* court however, presented no reasoning or explanation as a basis for the quoted language. From an examination of the text of the decisions, it is evident that *International Data Bank* is a reasoned decision, while the decision below and that of *Warner* are conclusory at best. In addition, as argued herein, *supra,* the reasoning set forth in *International Data Bank* by the Fourth Circuit is sound and should be followed by this Court.

This Court has already found the mandate to construe RICO broadly to be an insufficient basis for deciding certain questions before it and has stated that it would reach its decision, "[w]ith or without this admonition" that the provisions of RICO shall be "liberally construed to effectuate its remedial purposes." *See U.S. v. Turkette,* 452 U.S. 576, 587 (1981). In the *Sedima* dissent, Justice Powell noted:

> We ruled in Turkette and Russello that the statute must be read broadly and construed liberally to effectuate its remedial purposes, but like the legislative history to which the Court alludes, it is clear we were referring there to

> RICO's *criminal* provisions. It does not necessarily follow that the same principles apply to RICO's private civil provisions.

473 U.S. at 529 (Powell, J., dissenting).

In a concurring opinion in *H.J., Inc. v. Northwestern Bell Telephone Company,* 492 U.S. 229, 106 L.Ed.2d 195, 215 (1989), Justice Scalia, writing for himself with Justices Rehnquist, O'Connor and Kennedy joining, stated that the reaction to *Sedima* "promptly produced the widest and most persistent circuit split on an issue of federal law in recent memory" and that the Court was still being faced years and countless millions in damages and attorneys' fees later with some of the same questions. In effect, Justice Scalia said that a statute should be more helpful than stating "life is a fountain." 106 L. Ed. 2d at 215. To say that RICO should be construed broadly is an invitation to spray the fountain water of standing liberally in all directions. The plain language of RICO does not require such a result and while RICO is to be construed broadly, it is not to be construed inconsistent with its plain meaning, particularly when the mandate to construe broadly is of uncertain application to the civil RICO provisions here at issue. "Broadly" does not mean revolutionary, erratically or inconsistent with the plain meaning of the statute.

IX.

THE PURCHASER-SELLER STANDING REQUIREMENT OF FRAUD IN THE SALE OF SECURITIES SHOULD NOT BE CIRCUMVENTED BY PERMITTING THE PLEADING OF WIRE OR MAIL FRAUD AS A PREDICATE ACT OF RACKETEERING ACTIVITY ABSENT A SHOWING OF REQUISITE SECURITIES FRAUD STANDING.

It has been suggested in more than one quarter that RICO may have been a poorly drafted statute. *See, e.g.*

H.J. Inc., 492 U.S. 229, 106 L.Ed.2d at 214 ("RICO may be a poorly drafted statute . . . "); *Id.* at 217-18 (Scalia, J., concurring) (vagueness of "pattern" requirement); Bridges at 47 (courts have interpreted RICO provisions in inconsistent ways). This Court has said as much in *H.J., Inc.* although acknowledging that rewriting RICO is a job for Congress if it is so inclined and not for this Court. 106 L. Ed. 2d at 214. However, sensibly construing what there is of RICO is the responsibility of the courts.

As RICO now stands, there is a significant "loophole" in applying the requirement of purchaser-seller status for standing when fraud in the sale of securities is alleged as a predicate act of racketeering activity. The loophole is that even if a purchaser-seller standing requirement is made applicable, it may be circumvented by the device of pleading wire and mail fraud as predicate acts of racketeering activity as well as pleading securities fraud. That is what SIPC has done here. It would be cold comfort to the integrity of standing to enforce standing rigorously with respect to fraud in the sale of securities as a predicate act and open up the floodgates when the same conduct is alleged to constitute wire and mail fraud. Allegations of wire and mail fraud are particularly easy to make in the context of securities as invariably a telephone or mailing would have been made to someone even if the person who received the telephone call or mailing was not the actual victim of the fraud.[10]

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[10] The predicate acts of wire and mail fraud contain their own separate standing requirements which SIPC will

(Continued on following page)

The same principles of construction and interpretation of RICO §1964(c) should apply when the same conduct that is alleged to constitute "fraud in the sale of securities" as a predicate act of racketeering activity is alleged to constitute wire and mail fraud as a predicate of "racketeering activity." SIPC is no more injured directly by the conduct at issue when it is pleaded as mail or wire fraud than it was by pleading fraud in the sale of securities. Also, SIPC's causal connection to the harm complained of is just as tenuous when it casts the challenged conduct as wire or mail fraud than it is when SIPC classifies the conduct as "fraud in the sale of securities."

Wire and mail fraud were crimes without civil counterparts prior to the passage of RICO. *See* J.S. Rakoff and H.W. Goldstein, *RICO: Civil and Criminal Law Strategy* §2.02[1] (1991). There was no developed law of standing

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(Continued from previous page)

probably be unable to satisfy. SIPC will probably be unable to show that it relied on any misrepresentation of the defendants. *See Pelletier v. Zweifel*, 921 F.2d 1465, 1499-1500 (11th Cir. 1991); *County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1311 (2d Cir. 1990); *Brandenburg v. Seidel*, 859 F.2d 1179, 1188 n.10 (4th Cir. 1988).

In addition, SIPC will probably be unable to show that it was a "target" of the alleged scheme to defraud. *See Pelletier*, 921 F.2d at 1499 (11th Cir. 1990); *Sperber v. Boesky*, 849 F.2d at 64-66 (2d Cir. 1988); *Brandenburg*, 859 F.2d at 1188 (4th Cir. 1988).

with respect to these offenses as only prosecutorial authorities had standing to bring actions alleging these offenses prior to RICO. When the gist of the predicate act of which plaintiff complains sounds in securities fraud, whether or not it is openly alleged as such, the standing requirements contained in §1964(c) applicable to securities fraud should be equally applicable even if the allegations are recast in terms of wire and mail fraud.

The Eighth Circuit has considered this question and ruled accordingly without a lengthy explanation. In *Brannan v. Eisenstein*, 804 F.2d 1041 (8th Cir. 1986), the Court stated:

> Since we have affirmed the dismissal of the securities fraud claims, the same conduct cannot constitute a fraudulent scheme giving rise to a wire fraud claim. Thus, wire fraud also fails as a basis for racketeering activity.

Id. at 1047.

This reasoning should be adopted by this Court to implement the requirements in mail and wire fraud as a civil RICO predicate act that when fraud in the sale of securities is involved a person must be a purchaser or seller of securities to have standing under §1964(c).

X.
CONCLUSION

Civil RICO is not entirely a world of its own. When it attaches special consequences to conduct which the law already has categorized and regulated, such as "fraud in the sale of securities," the developed body of experience

and settled law, including provisions pertaining to standing, should be utilized in construing the relevant provisions of RICO. Even if the construction of civil RICO standing requirements is approached without reference to settled securities law decisions, the result is the same. A person who is neither a purchase nor seller of securities is not directly injured by, or injured by reason of, the fraud in the sale of securities and should not have standing under RICO §1964(c).

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Supreme Court of the United States

October Term, 1991

ROBERT G. HOLMES, JR.,

Petitioner,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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QUESTION PRESENTED

The Securities Investor Protection Corporation ("SIPC") sued Robert G. Holmes, Jr. ("Holmes") and others under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961-68 (1988) ("RICO"), for a complex scheme to manipulate securities that caused the multimillion dollar failure of two securities firms. The District Court granted summary judgment in favor of Holmes and the Ninth Circuit reversed. *SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986). As restated, the one issue presented in this appeal is as follows:

> Was the Ninth Circuit correct when it held that SIPC need not be a "purchaser or seller" of securities to sue under Section 1964(c), which provides that "any person" may sue for "injury to his business or property" "by reason of" "any offense . . . involving fraud in the sale of securities . . . punishable under any law of the United States," wire fraud, or mail fraud in violation of Section 1962?

LIST OF PARTIES

The petitioner is Robert G. Holmes, Jr. ("Holmes"), the respondent is the Securities Investor Protection Corporation ("SIPC").[1]

SIPC has no parent or subsidiary companies.

---

[1] Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated, and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation (collectively, the "Trustees"), were respondents to Holmes' Petition for a Writ of Certiorari. The Court granted certiorari on the first question presented in Holmes' petition. 111 S. Ct. 1618 (1991). This question concerns SIPC only. The Trustees have standing to assert violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, since Joseph Sebag Incorporated and First State Securities Corporation purchased and sold manipulated securities for their proprietary accounts.

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STATUTES INVOLVED

The text of the principal statutes and regulations involved in this appeal, the Racketeer Influenced and Corrupt Organizations Act (18 U.S.C. §§ 1961-68), the Securities Investor Protection Act (15 U.S.C. §§ 78aaa-78*lll*), Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5)) promulgated thereunder, and Section 32 of the Securities Exchange Act of 1934 (15 U.S.C. § 78ff), is set forth in the Appendix hereto.

STATEMENT OF THE CASE

SIPC and its Trustees filed this action on July 22, 1983, for damages sustained as a result of the collapse of Joseph Sebag Incorporated ("Sebag") of Los Angeles, California and First State Securities Corporation ("FSSC") of Miami, Florida.[2] The First Amended Complaint alleges claims against Holmes for violations of RICO, the Securities Exchange Act of 1934 ("1934 Act"), 48 Stat. 891, 15 U.S.C. § 78j(b), and common law fraud.[3]

The First Amended Complaint alleges that Holmes and others engaged in schemes to manipulate the over-the-counter stock market that caused the failures of FSSC and Sebag and the loss of brokerage customers' securities and cash.[4] Laurence A. Schroeder (as successor to John L. Britton) and Eugene W. Bell were appointed as trustees to liquidate FSSC and Sebag, under the Securities Investor Protection Act of 1970, as amended[5] ("SIPA").

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[2] District Court Clerk's Record ("C.R.") 1, p. 1.

[3] C.R. 248, pp. 6-47, 62-78, 141-48.

[4] Holmes and his co-defendants manipulated six different securities issued by Aero Systems, Inc., Aerosonics Corporation, Bunnington Corporation, Creditbank, Inc., Dash Industries, Inc. and Osrow Products Corporation (hereinafter "Target Securities").

[5] Pub. L. No. 91-598, 84 Stat. 1636 (1970) (codified as amended 15 U.S.C. §§ 78aaa-78*lll*).

As a result of acts of Holmes[6] and his co-conspirators, the Trustees suffered damages of approximately $16 million, and SIPC was injured by more than $12.5 million.

In the District Court, Holmes moved for summary judgment asserting a lack of causation between Holmes' conduct and injuries to SIPC and its Trustees. He also contended that SIPC lacked standing because SIPC was not a "purchaser or seller" of securities. On October 31, 1988, the District Court granted Holmes' motions, and SIPC and its Trustees appealed.[7]

The District Court found a genuine dispute existed as to material facts on the RICO issues.[8] The District Court found that: (1) an issue of fact was raised that "Holmes conspired to violate RICO sections 1962(a), 1962(b), or 1962(c);"[9] and (2) an issue of fact was raised whether the predicate acts caused "the injuries" of SIPC and its Trustees.[10] The District Court then found that (1) "The grant of summary judgment on 'causation' applies also to the RICO claims", and; (2) "SIPC does not meet the 'purchaser-seller'

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[6] Holmes is the founder, president, chief executive officer, director and major shareholder of Aero Systems, Inc. ("Aero Systems"), an airplane used parts dealer in Miami, Florida. (C.R. 1293, pp. 4-5.) Aero Systems' stock was manipulated by Holmes (C.R. 1310, pp. 13-15), as was the stock of Bunnington Corporation ("Bunnington"). (C.R. 1310, pp. 37-43.) Bunnington's major shareholders were co-conspirators Vigman and his brother-in-law Isadore Diamond. (C.R. 1317, p. 37.)

[7] C.R. 1344, p. 2. In addition, the District Court entered another order on October 26, 1988, that SIPC "lacks standing" to assert claims against Holmes under Rule 10b-5. Order for Partial Summary Judgment. (C.R. 1341, p. 2.) The Court's basis for summary judgment, in light of *SIPC v. Vigman*, 803 F.2d 1513, 1519 (9th Cir. 1986) (SIPC must be purchaser or seller to sue under Rule 10b-5), was: "6. There is no evidence (SIPC having the burden under *Celotex*) that any pledge of fully paid for customer stock was 'unauthorized.' " (C.R. 1340, p. 6.) By its ruling in 1986, the Ninth Circuit unfortunately limited SIPC's ability to use the securities laws. *See* discussion *infra* n. 252 SIPC's ability to use RICO here must not be similarly so limited.

[8] C.R. 1343, pp. 2-3, ¶¶ 2-4, 6 and 7.

[9] *Id.*, ¶ 5.

[10] *Id.*, ¶ 8.

requirements for standing to assert RICO claims . . . predicated on violations of Section 10(b) and Rule 10b-5 of the 1934 Securities Exchange Act."[11]

The Ninth Circuit reversed. Holmes petitioned this Court for review. This Court granted certiorari solely on the issue of whether SIPC must be a "purchaser or seller" of securities.[12]

SUMMARY OF ARGUMENT

The text of RICO, including its Liberal Construction Clause and No Supersession Clause, as well as its legislative history, are inconsistent with the imposition of a limitation on standing. RICO's civil remedy section unambiguously confers standing on all entities who are capable of holding a legal or beneficial interest in property. No legal basis exists to engraft *implied* standing principles borrowed from the civil remedial structure of an underlying predicate offense on RICO's own *express* civil remedy. In fact, RICO and the 1934 Act specifically preserve remedies under other laws. No satisfactory justification can be offered why limitations on private civil securities claims should be read into the mail fraud or wire fraud offenses.

Holmes' belated effort to shift attention away from RICO's express standing provision and focus on the "by reason of" causation and the "in his business or property" elements of RICO's civil remedy provision is outside of the grant of certiorari and without merit. In fact, the Ninth Circuit found that SIPC raised a triable issue of fact that Holmes and his co-conspirators caused SIPC's injury, and this Court denied certiorari. SIPC, statutorily and as a matter of common law, is a real party in interest in litigation related to broker-dealer liquidations and is subrogated to the rights of customers. SIPC may, therefore, properly assert the various business and property damage claims. In short, Holmes' effort

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[11] The District Court did not address the mail fraud and wire fraud predicate offenses SIPC and its Trustees alleged and substantiated.

[12] 111 S. Ct. 1618 (1991).

to conflate causation or injury with standing to sue ought to be rejected.

Finally, even though Holmes' policy considerations cannot override text and legislative history, and are properly directed to Congress, empirical data show fears of a RICO litigation explosion are without support. Similarly, no evidence supports Holmes' assertion that RICO is particularly susceptible to abuse or that it is being misused. In fact, RICO's private treble damage enforcement mechanism is essential to maintain integrity in the market place.

In sum, the judgment of the Ninth Circuit should be affirmed.

ARGUMENT

I. Because SIPC Serves The Public Interest, It Must Be Allowed To Use RICO To Assist In The Regulation Of The Securities Market.

In 1970, Congress created SIPC under SIPA in response to the collapse of numerous brokerage houses to provide protection for customers of registered brokers, dealers, and members of national securities exchanges.[13] Congress analogized SIPC's role to that of the federal corporations that insure savings and demand deposits.[14] The new program was sponsored by the securities industry and the Securities and Exchange Commission ("Commission").[15] The purposes of the program were:

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[13] 15 U.S.C. § 78ccc; S. Rep. No. 1218, 91st Cong., 2d Sess. 3 (1970); H.R. Rep. No. 1613, 91st Cong., 2d Sess. 4 (1970). Membership in SIPC is automatic upon registration as a broker or dealer with the Securities and Exchange Commission under Section 15(b) of the 1934 Act. 15 U.S.C. § 78ccc(a)(2)(A).

[14] S. Rep. No. 1218, 91st Cong., 2d Sess. 4 (1970).

[15] H.R. Rep. No. 1613, 91st Cong., 2d Sess. 28 (1970); *Hearing on S. 2348, S. 3988, S. 3989 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 12 (1970); *Hearings*

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> to protect individual investors from financial hardship; to insulate the economy from the disruption which can follow the failure of major financial institutions; and to achieve a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss.[16]

SIPA accomplished these purposes in two ways.[17] First, it enhanced the Commission's powers to establish financial responsibility rules for brokers and dealers[18] and to impose on the self-regulatory organizations[19] requirements for the financial examination of their members.[20] Second, it established SIPC.

Congress required SIPC to establish a fund through assessments upon its members,[21] and it authorized SIPC to borrow against the United States Treasury up to $1 billion.[22]

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on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, H.R. 18458: Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess. 330 (1970).

[16] S. Rep. No. 1218, 91st Cong., 2d Sess. 4 (1970); *see also* H.R. Rep. No. 1613, 91st Cong., 2d Sess. 1 (1970).

[17] *See generally SIPC v. Barbour*, 421 U.S. 412, 415-16 (1975). *See also In re Application of Executive Secs. Corp.*, 702 F.2d 406, 410 (2d Cir.) ("SIPC and its trustees vindicate important public interests"), *cert. denied*, 464 U.S. 818 (1983); SIPC, *1990 Annual Report* 7 (1991) (320,000 customer claims were satisfied in the liquidation of 220 firms over 20 years at a cost of $224,404,844); L. Sloane, *The Safety Net For Securities Holders*, N.Y. Times, Jan. 5, 1991, at 14, col. 14.

[18] 15 U.S.C. §§ 78ccc(e)(3), 78ggg(a).

[19] "Self-regulatory organizations" consist of national securities exchanges and the National Association of Securities Dealers, Inc. ("NASD").

[20] 15 U.S.C. § 78iii(f). Similarly, SIPC is required to work with the self-regulatory organizations to standardize examining procedures and to develop procedures for the early detection of financial difficulty of SIPC members. 15 U.S.C. § 78iii(e).

[21] 15 U.S.C. § 78ddd.

[22] 15 U.S.C. § 78ddd(f)-(h).

SIPA provides that customers' claims will be first satisfied from the assets held by the failed broker-dealer constituting a "fund of customer property,"[23] in which all customers share ratably to the exclusion of general creditors.[24] SIPC funds, therefore, only supplement the fund of customer property.[25]

Each innocent customer with a claim is assured of protection by SIPC.[26] Thus, a significant part of the business of

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[23] 15 U.S.C. §§ 78*lll*(4), 78fff-2(c)(1). Procedurally, a SIPA trustee marshals the assets of the failed broker-dealer and creates a "fund of customer property." The fund consists of cash and securities held by the failed broker-dealer for customers. 15 U.S.C. § 78*lll*(4). The fund does not include securities registered in the customer's name. 15 U.S.C. § 78*lll*(3)-(4). Thus, in a SIPA liquidation a customer has any securities registered in his own name returned to him; a customer's "street-name" securities and cash in the customer's account are pooled in the "fund of customer property."

[24] 15 U.S.C. § 78fff-2(c)(1). Before SIPA, customers only received their *pro rata* share of the fund (then called "single and separate fund," now called the "fund of customer property"). As for unpaid balances, customers shared with general creditors in the general estate. *See* 3 *Collier on Bankruptcy* §§ 60.73-60.76 (14th ed. 1977). Because the fund was usually inadequate, customers suffered losses. Congress moved to remedy these losses by setting up SIPC and its fund to make customers whole, within the limits of SIPA.

[25] SIPC may advance up to $500,000 for each customer for the amount by which such customer's "net equity" exceeds his *pro rata* share of the fund of customer property, but in no event more than $100,000 for that portion of a claim that is for cash. 15 U.S.C. § 78fff-3(a)(1). "Net equity" is the filing date value of securities and cash the failed broker-dealer owes the customer less any amount the customer owes the broker-dealer. 15 U.S.C. § 78*lll*(11). For example, if the fund of customer property totaled $100,000 and the total value of the net equities of all of the customers was $1 million, the customers would share the $100,000 on a *pro rata* basis and SIPC would supplement the fund for each customer (over what the customer received from the fund) to the statutory limits.

[26] Customers of the two failed brokerages generally break down into two groups – those who purchased manipulated Target Securities and those who did not. Their ability to recover losses against manipulators are widely disparate under federal law.

Customers who purchased Target Securities share in the fund of customer property, receive reimbursement from SIPC to the extent that the fund

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SIPC is to advance funds to satisfy the claims of investors whose broker-dealer was injured by fraudulent acts. SIPC is then subrogated to the claims of such customers, including claims against third parties.[27]

In July 1983, the net capital of FSSC and Sebag fell below the statutory limits, and SIPC applied to the courts for the appointment of trustees to liquidate the firms under SIPA.[28] SIPC then advanced more than $12.5 million to satisfy customer claims and to pay expenses of liquidation.[29] In

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of customer property cannot satisfy the customers' net equity claim, and have an action based on Rule 10b-5 or RICO against the manipulators for the difference in price between the Target Securities as manipulated and the price of the Target Securities, post collapse. A class action consisting only of purchasers and sellers of Target Securities has been certified and is consolidated with this case for the purpose of discovery. C.R. 475 (*Cain v. Vigman*, No. 83-5674 AWT (Tx)).

Customers who did not purchase the Target Securities also share in the fund of customer property and receive a reimbursement from SIPC to the extent that their net equity claims are not satisfied by the fund. These customers cannot pursue a Rule 10b-5 action against the manipulators because they neither bought nor sold the Target Securities. With SIPC, this class of customers is, however, virtually made whole, and SIPC succeeds to their rights. Nevertheless, if the Ninth Circuit's decision were reversed, an anomaly would be produced. This class of customers, to whose rights SIPC has now partially succeeded, were victimized by conduct that could be made the subject of a federal RICO criminal prosecution, in which they would be the complaining witnesses. But because they are not purchasers or sellers, neither they nor SIPC would have a civil claim for relief for losses under RICO.

[27] 15 U.S.C. § 78fff-3(a). *See* discussion *infra* n.182.

[28] A net capital deficiency is determined in accordance with SEC Rule 15c3-1. 17 C.F.R. § 240.15c3-1 (1990). Under the Rule, a broker-dealer's liabilities, or "aggregate indebtedness," may not exceed its net capital by more than 1500%. "Net capital" is calculated as net worth less downward provisions for non-liquid assets, missing securities, inventory "haircuts" and other risk associated factors. C.R. 1310, p. 20 ¶ 31 n.7. For example, here FSSC had a net capital deficiency of $2,634,976. C.R. 1310, p. 36, ¶ 86. The deficiencies were caused in substantial part by the acts of Holmes and his co-conspirators. C.R. 1310, p. 34, ¶ 80. *See* discussion *infra* n.226.

[29] C.R. 1317, p. 109.

addition, the Trustees, as successors to the brokerage firms, lost in excess of $16 million.

II. SIPC Need Not Be A Purchaser Or Seller Of Securities To Maintain An Action Under 18 U.S.C. Section 1964(c).

Holmes and his co-conspirators used FSSC and Sebag as tools of their scheme to defraud. Their conspiratorial conduct violated the federal securities laws and the federal mail fraud and wire fraud statutes. Their conduct also fell within the provisions of RICO.

A. RICO Provides A Critical Remedial Framework For Victims Of The Sort Of Massive Stock Manipulation That Holmes And His Co-Conspirators Perpetrated.

1. The Background Of RICO.

In 1970, Congress enacted SIPA and the Organized Crime Control Act, Title IX of which is known as RICO.[30]

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[30] Pub. L. No. 91-452, 84 Stat. 922 (1970) (codified as amended at 18 U.S.C. §§ 1961-68 (1988 & Supp. I 1989)). Commentary on RICO is extensive. *See generally* Blakey & Perry, *An Analysis of the Myths that Bolster Efforts to Rewrite RICO and the Various Proposals For Reform*, 43 Vand. L. Rev. 851 (1990) (hereinafter "*Myths*"); Blakey, *The RICO Civil Fraud Action in Context: Reflections on Bennett v. Berg*, 58 Notre Dame L. Rev. 237 (1982) (hereinafter "*Civil Fraud Action*"); Blakey & Cessar, *Equitable Relief Under Civil RICO*, 62 Notre Dame L. Rev. 526 (1987) (hereinafter "*Equitable Relief*"); Blakey & Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts – Criminal and Civil Remedies*, 53 Temp. L.Q. 1009 (1980) (hereinafter "*Basic Concepts*"); Lynch, *RICO: The Crime of Being a Criminal* (pts. 1-4), 87 Colum. L. Rev. 661, 920 (1987); Goldsmith, *RICO and Enterprise Criminality: A Response to Gerard E. Lynch*, 88 Colum. L. Rev. 774 (1988) (hereinafter "*Goldsmith on RICO*"); Lynch, *A Reply to Michael Goldsmith*, 88 Colum. L. Rev. 802 (1988). Three recent symposia are: *Symposium: The 20th Anniversary of the Racketeer Influenced and Corrupt Organizations Act (1970-1990)*, 64 St. John's L. Rev. 701 (1990); *Symposium: Reforming RICO: If, Why, and How?*, 43 Vand. L. Rev. 621 (1990); and *Symposium: Law and The Continuing Enterprise: Perspectives on RICO*, 65 Notre Dame L. Rev. 872 (1990).

Title IX addresses "enterprise criminality"[31] involving fraud.[32] Congress was concerned with "fraud."[33] In particular, Congress wanted to protect "innocent investors."[34] Because Congress found that "the sanctions and remedies available" were "unnecessarily limited in scope and impact,"[35] Congress enacted RICO to provide criminal and civil sanctions, including imprisonment, forfeiture, injunctions, and treble damage relief for "person[s] injured" in their "business or property" "by reason of" a violation of the statute.[36]

The "legislative history [of RICO] clearly demonstrates that . . . [it] was intended to provide new weapons of unprecedented scope for an assault upon organized crime and its economic roots."[37] "[T]he major purpose of [RICO was] to address the infiltration of legitimate business by organized crime," but the statute was designed to reach both "illegitimate" and "legitimate" enterprises.[38] Nevertheless, as this Court observed in *H.J. Inc. v. Northwestern Bell Telephone Co.*: "[the notion that RICO is limited to organized crime] finds no support in the Act's text, and is at odds with the tenor of its legislative history. . . ."[39] "Congress drafted RICO broadly enough to encompass a wide range of criminal

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[31] *United States v. Cauble*, 706 F.2d 1322, 1330 (5th Cir. 1983) (" 'enterprise criminality' " consists of "all types of organized criminal behavior '[ranging] from simple political corruption to sophisticated white-collar crime schemes to traditional Mafia-type endeavors.' ") (quoting *Basic Concepts* at 1013-14), *cert. denied*, 465 U.S. 1005 (1984).

[32] *Civil Fraud Action* at 300-06 (analysis of RICO's various predicate offenses).

[33] 84 Stat. 922 (1970).

[34] 84 Stat. 923 (1970).

[35] *Id.*

[36] 18 U.S.C. §§ 1963, 1964(c).

[37] *Russello v. United States*, 464 U.S. 16, 27 (1983).

[38] *United States v. Turkette*, 452 U.S. 576, 590-91 (1981).

[39] 492 U.S. 229, 244-48 (1988). "[C]ourts and . . . commentators have persuasively and exhaustively explained why . . . [RICO] . . . [is not limited] to organized crime. . . . " *Owl Const. Co. v. Ronald Adams Contractor, Inc.*, 727 F.2d 540, 542 (5th Cir.), *cert. denied*, 469 U.S. 831 (1984).

activity. . . . "[40] "[Legitimate businesses] enjoy neither an inherent incapacity for criminal activity nor immunity from its consequences."[41] Accordingly, RICO fits into a pattern of legislation enacted as general reform, aimed at a specific target, but not limited to the specific target.[42]

Congress directed that RICO "be liberally construed to effectuate its remedial purposes."[43] If RICO's language is

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[40] *H.J. Inc.*, 492 U.S. at 248-49.

[41] *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 499 (1985).

[42] *See, e.g., United States v. Culbert*, 435 U.S. 371, 373-74 (1978); *Perrin v. United States*, 444 U.S. 37, 46 (1979); *United States v. Fabrizio*, 385 U.S. 263, 265-67 (1966); *Bell v. United States*, 462 U.S. 356, 358-62 (1983); *Caminetti v. United States*, 242 U.S. 470, 485-90 (1917). *See generally Equitable Relief* at 529 n.13 (other cases collected); *id.* at 568 n.189 (similar drafting of Klu Klux Klan Act of 1871 and Sherman Antitrust Act of 1890); Blakey, *Definition of Organized Crime in Statutes and Law Enforcement Administration*, in President's Commission on Organized Crime: Report To The President And The Attorney General – *The Impact: Organized Crime Today* 511-80 (April 1986).

[43] 84 Stat. 947 (1970). *See Equitable Relief* at 532 n.21 (origin of clause traced to work of Edward Livingston between 1820 and 1825). Judicial hostility to change through legislation was common in the 19th century. J. Hurst, *The Growth Of American Law* 186 (1950). It became standard practice in drafting statutes to insert a preamble stating broadly the purpose of the act and to close with a provision declaring that the statute should be liberally construed. D. Wigdor, *Roscoe Pound: Philosopher of Law* 174 (1974). In fact, a majority of states have abolished the common law rule of strict construction. *Civil Fraud Action* at 245 n.25. *See also id.* at 288 n.150 (analysis of relation between rules of construction, including rule of lenity, and Liberal Construction Clause). Strict construction is not required by the Constitution. *Tarrant v. Ponte*, 751 F.2d 459, 466 (1st Cir. 1985). Circuit courts faithfully follow its mandate in criminal litigation. *United States v. Angiulo*, 897 F.2d 1169, 1216 (1st Cir.), *cert. denied*, 111 S. Ct. 130 (1990); *United States v. Mazzei*, 700 F.2d 85, 89-90 (2d Cir.), *cert. denied*, 461 U.S. 945 (1983); *United States v. Frumento*, 563 F.2d 1083, 1090-91 (3d Cir. 1977), *cert. denied*, 434 U.S. 1072 (1978); *In re Billman*, 915 F.2d 916, 921 (4th Cir.), *cert. denied*, 111 S. Ct. 2258 (1991); *United States v. Elliott*, 571 F.2d 880, 897-98 (5th Cir.), *cert. denied*, 439 U.S. 953 (1978); *United States v. Sutton*, 642 F.2d 1001, 1003 (6th Cir. 1980), *cert. denied*, 453 U.S. 912 (1981); *United States v. Grzywacz*, 603 F.2d 682, 685-86 (7th Cir. 1979), *cert. denied*, 446 U.S. 935 (1980); *United States v. Godoy*, 678

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plain, it controls;[44] if its language, syntax, or context is ambiguous, the construction that would "effectuate its remedial purposes" "by providing enhanced sanctions and new remedies" is to be adopted.[45] Its language is to be read in the same fashion, whatever the character of the suit.[46]

"Congress was well aware that it was entering a new domain."[47] An issue was whether RICO should preempt other remedies. Congress, however, saved "provision[s] of federal, state, or other law imposing criminal penalties or affording civil remedies in addition to those provided for" in RICO.[48]

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F.2d 84, 86-87 (9th Cir. 1982), *cert. denied*, 464 U.S. 959 (1983); *United States v. Hartley*, 678 F.2d 961, 988 (11th Cir. 1982), *cert. denied*, 459 U.S. 1170 *and* 1183 (1983); and *United States v. Perholtz*, 842 F.2d 343, 353 (D.C. Cir.), *cert. denied*, 488 U.S. 821 (1988).

It is ironic, therefore, when litigants, as here, expect this Court to ignore the Liberal Construction Clause in civil litigation. *See Sedima*, 473 U.S. at 491 n.10.

[44] *Turkette*, 452 U.S. at 587 n.10; *Russello* 464 U.S. at 29; *Shearson/ American Express, Inc. v. McMahon*, 482 U.S. 220, 239, *reh'g denied*, 483 U.S. 1056 (1987); *United States v. Monsanto*, 491 U.S. 600, 606 (1989); *H.J. Inc.*, 492 U.S. at 249.

[45] 84 Stat. 923, 947 (1970); *Turkette*, 452 U.S. at 587-88, 593; *Russello*, 464 U.S. at 27; *Sedima*, 473 U.S. at 497-98; *Monsanto*, 491 U.S. at 609; *Tafflin v. Levitt*, 110 S. Ct. 792, 799 (1990).

[46] *Sedima*, 473 U.S. at 489; *Shearson*, 482 U.S. at 239; *cf. Northern Sec. Co. v. United States*, 193 U.S. 197 (1904) (Holmes, J., dissenting) ("The words cannot be read one way in a suit which is to end in fine and imprisonment and another way in one which seeks an injunction").

[47] *Turkette*, 452 U.S. at 586.

[48] 84 Stat. 947 (1970). *Cf. FMC Corp. v. Holliday*, 111 S. Ct. 403, 408 (1990). Such clauses are a feature of federal statutes. *See, e.g.*, Securities Exchange Act of 1934, ch. 404, § 28(a), 48 Stat. 881, 903 (codified as amended at 15 U.S.C. § 78bb(a) (1988)) ("rights and remedies" "in addition" to "any and all other rights" that exist). SIPA is considered an amendment to the 1934 Act. 84 Stat. 1634 (1970). Congress frequently enacts overlapping statutes. *See, e.g., United States v. Batchelder*, 442 U.S. 114, 118-21 (1979); *United States v. Bishop*, 412 U.S. 346, 350-61 (1973); *United States v. Beacon Brass Co.*, 344 U.S. 43, 45-47 (1952); *United States v. Gilliland*, 312 U.S. 86, 95-96 (1941). This Court does not prohibit the application of two statutes to the same conduct. *See United States v. Maze*, 414 U.S. 395, 405-09 (1974) (Burger, C.J., dissenting) ("The mail

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"Congress enacted RICO in order to supplement, not supplant, the available remedies since it thought those remedies offered too little protection for the victims."[49] Such overlap between statutes "is neither unusual nor unfortunate."[50] The existence of cumulative remedies furthers remedial purposes.[51]

2. Standards Of Unlawful Conduct Under RICO.

Title 18, United States Code, Section 1962, sets forth standards of "unlawful" conduct. Section 1963 sets out criminal penalties, and section 1964 sets out civil remedies. RICO is not primarily criminal and punitive, but primarily civil and remedial.[52]

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fraud statute continues to remain an important tool in prosecuting frauds in those areas where legislation has been passed more directly addressing the fraudulent conduct . . . [including] securities fraud. . . . "); *United States v. Weatherspoon*, 581 F.2d 595, 599-602 (7th Cir. 1978) (18 U.S.C. §§ 1001, 1341, 1963 may co-exist); *United States v. Brewer*, 528 F.2d 492, 497-98 (4th Cir. 1975) (18 U.S.C. § 1341 and 15 U.S.C. § 375 may co-exist) (citing *Edwards v. United States*, 312 U.S. 473 (1941) (mail fraud and securities fraud)). The securities laws and RICO may, therefore, properly each apply to the same conduct; remedies under each are *expressly* preserved by their texts.

[49] *Haroco, Inc. v. American Nat'l Bank & Trust Co. of Chicago*, 747 F.2d 384, 392 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985). *See* Goldsmith, *Civil RICO Reform*, 71 Minn. L. Rev. 827, 840-48 (1987).

[50] *SEC v. National Sec., Inc.*, 393 U.S. 453, 468 (1969).

[51] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 (1983).

[52] *Turkette*, 452 U.S. at 592-93; *Sedima*, 473 U.S. at 497-98; *Shearson*, 482 U.S. at 238-42; *Tafflin*, 110 S. Ct. at 799 (citing *Sedima*, 473 U.S. at 492 n.10). Statutory classifications control over federal common law classifications. *City of Milwaukee v. Illinois*, 451 U.S. 304, 312-15 (1981). When Congress so classifies a statute, the classification is entitled to great deference. *United States v. One Assortment of 89 Firearms*, 465 U.S. 354, 365 (1984). *See also* 115 Cong. Rec. 6993 (1969) (Stat. of Sen. Hruska) ("[T]he criminal provisions are intended primarily as an adjunct to the civil provisions which I consider as the more important feature of the bill."); 116 Cong. Rec. 602 (1970) (Stat. of Sen. Hruska) ("the principal value of this legislation may well be found to exist in its civil provisions").

a. Predicate Offenses.

Title 18, United States Code, Section 1961(1) defines RICO's predicate offenses and includes:

> Any act . . . under . . . title 18, . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud) . . . [and] any offense involving . . . fraud in the sale of securities . . . punishable under any law of the United States. . . .

(i) *Mail And Wire Fraud.*

Title 18, United States Code, Sections 1341 and 1343 prohibit "devis[ing] . . . any scheme . . . to defraud [and] . . . executing such scheme" by mailing a letter or using an interstate wire communication.

(ii) *Fraud In Sale Of Securities.*

Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), makes it

> unlawful for any person . . . by the use of any means . . . of interstate commerce or of the mails . . . to use . . . in connection with the purchase or sale of any security . . . any manipulative . . . device . . . in contravention of such rules and regulations as the [Securities and Exchange] [C]ommission may prescribe. . . .

The Commission promulgated Rule 10b-5, 17 C.F.R. § 240.10b-5, which provides, in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of . . . interstate commerce, or of the mails . . .
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> * * *
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

(iii) *Securities Criminal Provision.*

Section 32(a) of the 1934 Act, 15 U.S.C. § 78ff(a), provides, in relevant part:

> Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful . . . shall upon conviction . . . be fined . . . or imprisoned . . . , or both. . . .

The 1934 Act was passed to "insure the maintenance of fair and honest markets in [securities] transactions."[53] Section 10(b) is "a 'catchall' clause to enable the Commission 'to deal with new manipulative [or cunning] devices.' "[54] The statute and Rule 10b-5 "prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception."[55] They "preserv[e] the integrity of the securities market,"[56] a goal that serves the market as a whole.[57]

b. Person.

Title 18, United States Code, Section 1961(3) provides, in relevant part:

> (3) 'person' includes any individual or entity capable of holding a legal or beneficial interest in property. . . .

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[53] 48 Stat. 882 (1934).

[54] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (brackets in original), *reh'g denied*, 425 U.S. 986 (1976).

[55] *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 11 n.7 (1971) (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (emphasis in original). *See United States v. Naftalin*, 441 U.S. 768, 773 (1979); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151, *reh'g denied*, 407 U.S. 916 (1972); S. Rep. No. 792, 73d Cong., 2d Sess. 6 (1934).

[56] *Bankers Life*, 404 U.S. at 12.

[57] *Naftalin*, 441 U.S. at 776.

c. Standards.

Title 18, United States Code, Sections 1962(c) and (d), provides, in relevant part:

> (c) It shall be unlawful for any person . . . associated with any enterprise engaged in . . . interstate . . . commerce, to . . . participate . . . in the conduct of . . . [its] affairs through a pattern of racketeering activity. . . .
>
> (d) It shall be unlawful for any person to conspire to violate any of the provisions . . . of this section.[58]

Sections 1962(c) and (d) set the standards against which any person's conduct in a criminal or civil RICO action must be measured to determine if it is "unlawful." They establish, in short, the "wrong."

3. Section 1964(c): RICO's Private Enforcement Mechanism.

Title 18, Section 1964(c), RICO's private enforcement mechanism, provides:

> Any person injured in his business or property by reason of a violation of section 1962 . . . may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

Section 1964(c) expressly sets out the "victim" who can sue ("any person"), "injury" ("injury to business or property"), the "wrong" giving rise to a claim for relief ("a violation of section 1962"), "cause" ("by reason of"), "forum" ("any appropriate United States district court"), and "remedy" (treble damages, attorneys' fees, and costs).

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[58] The First Amended Complaint of SIPC and its Trustees also alleges violations of Sections (a) and (b). J.A. at 54. This brief focuses only on Sections (c) and (d).

Like the antitrust statutes,[59] RICO's civil provisions "create a private enforcement mechanism that . . . deter[s] violators . . . [and] provide[s] ample compensation to the victims."[60] RICO's treble damage provisions "provide strong incentives to civil litigants and are integral to the effort of Congress to enlist the aid of civil claimants in deterring" violations of RICO.[61] Such "private . . . litigation is one of the surest weapons for effective enforcement"[62] of the law; it "provide[s] a significant supplement to the limited resources available to [the government]."[63]

B. The Ninth Circuit Correctly Relied On The Statute's Plain Meaning And Rejected A Purchaser-Seller Limitation On RICO.

The Ninth Circuit's rejection of a purchaser-seller limitation reflects the statute's plain meaning.[64] The interpretation of RICO begins with its text; structure, legislative history, and congressional policy, as well as language, are

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[59] S. Rep. No. 617, 91st Cong., 1st Sess. 81, 157-61 (1969); H.R. Rep. No. 1549, 91st Cong., 2d Sess. 56-60 (1970). "Even a cursory comparison of the two statutes reveals that the civil action provision of RICO was patterned after the Clayton Act." *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 483 U.S. 143, 150 (1987).

[60] *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 472 (1982).

[61] *Alcorn County v. U.S. Interstate Supplies, Inc.*, 731 F.2d 1160, 1165 (5th Cir. 1984).

[62] *Leh v. General Petroleum Corp.*, 382 U.S. 54, 59 (1965) (quoting *Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co.*, 381 U.S. 311, 318 (1965)), *reh'g denied*, 382 U.S. 1001 (1966).

[63] *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344 (1979).

[64] 908 F.2d at 1467. The Ninth Circuit's well-reasoned opinion is beginning to command general acceptance. *See, e.g., Ford Motor Co. v. Summit Motor Products, Inc.*, 930 F.2d 277, 285-86 (3d Cir. 1991).

important.[65] Title 18, Section 1964(c) provides an express claim for relief that sets forth "victim", "injury", "cause",

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[65] Four basic assumptions are integral to any principled effort to interpret a statute: (1) legislative supremacy within the constitutional framework; (2) the use of the statutory vehicle to exercise that supremacy; (3) reliance on accepted means of communication; and (4) reasonable availability of the statutory vehicle to those to be governed by it, not only its text, but any other part of its legislative context that serves to give it meaning. R. Dickerson, *The Interpretation and Application of Statutes* 7-12 (1975).

This Court, in its RICO decisions in *Turkette, Russello, Sedima, Agency Holding Corp., Shearson, Caplin & Drysdale v. United States*, 491 U.S. 617 (1989), *Monsanto, Tafflin*, and *H.J. Inc.* acknowledged several general propositions of statutory construction, established the basic principles that govern the reading of RICO, and consistently applied them to the statute:

> (1) read the language of the statute (*Turkette*, 452 U.S. at 580, 593; *Russello*, 464 U.S. at 20 (citing *Turkette*); *Sedima*, 473 U.S. at 495 n.13; *Shearson*, 482 U.S. at 227; *Monsanto*, 491 U.S. at 606 (citing *Turkette*); *H.J. Inc.*, 492 U.S. at 237 (citing *Russello*));
>
> (2) language includes its structure (*Turkette*, 452 U.S. at 582, 587; *Russello*, 464 U.S. at 22-23; *Sedima*, 473 U.S. at 490 n.8, 496 n.14; *Agency Holding Corp.*, 483 U.S. at 152);
>
> (3) language should be read in its ordinary or plain meaning, but must be viewed in context (*Turkette*, 452 U.S. at 580, 583 n.5, 587; *Russello*, 464 U.S. at 20 (citing *Turkette*), 21-23, 25; *Sedima*, 473 U.S. at 495 n.13; *H.J. Inc.*, 492 U.S. at 238 (citing *Richards v. United States*, 369 U.S. 1, 9 (1962));
>
> (4) language should not be read differently in criminal and civil proceedings (*Sedima*, 473 U.S. at 489, 492; *Shearson*, 482 U.S. at 239-40);
>
> (5) look to the legislative history of the statute (*Turkette*, 452 U.S. at 586, 589; *Sedima*, 473 U.S. at 486, 489; *Shearson*, 482 U.S. at 238-41; *Agency Holding Corp.*, 483 U.S. at 151; *Monsanto*, 491 U.S. at 613; *H.J. Inc.*, 492 U.S. at 236-39 (citing *Sedima*); *Tafflin*, 110 S. Ct. at 796);
>
> (6) look to the policy of the statute (*Turkette*, 452 U.S. at 590; *Russello*, 464 U.S. at 24; *Sedima*, 473 U.S. at 493; *Tafflin*, 110 S. Ct. at 799);
>
> (7) the statute was aimed at the infiltration of legitimate business by organized crime (*Turkette*, 452 U.S. at 591; *Russello*, 464 U.S. at 26, 28 (citing *Turkette*); *Caplin & Drysdale*, 491 U.S. at 630; *H.J. Inc.*, 492 U.S. at 245 (citing *Russello* and *Turkette*));

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"wrong", "forum", and "remedy." "Person", which defines "victim", includes "any entity." 18 U.S.C. § 1961(3). "Any" means "all", not "some, but not others."[66] SIPC is an entity capable of "holding a legal or beneficial interest in property."[67] "Racketeering activity", which is an element of a violation, "means" "section 1341 (relating to mail fraud),

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(8) the statute was not limited to the infiltration of legitimate business by organized crime (*Turkette*, 452 U.S. at 590-91; *Russello*, 464 U.S. at 28; *Sedima*, 473 U.S. at 495, 499; *H.J. Inc.*, 492 U.S. at 242-49 (citing *Sedima*));

(9) the statute is to be broadly read and liberally construed (*Turkette*, 452 U.S. at 587, 593; *Russello*, 464 U.S. at 21; *Sedima*, 473 U.S. at 491 n.10, 497-98; *Monsanto*, 491 U.S. at 609 (citing *Sedima*); *H.J. Inc.*, 492 U.S. at 237; *Tafflin*, 110 S. Ct. at 799 (citing *Sedima*));

(10) where Congress rejects proposed limiting language in a bill, it may be presumed that the limitation was not intended (*Russello*, 464 U.S. at 23-24; *Sedima*, 473 U.S. at 498); and

(11) where Congress includes or omits limiting language in a bill, it is presumed that it did so intentionally (*Turkette*, 452 U.S. at 581; *Russello*, 464 U.S. at 23).

Nevertheless, more than 100 years ago, this Court noted that "[i]t is easy, by very ingenious and astute construction, to evade the force of almost any statute, where a court is so disposed. . . . [By] such a construction [it is possible to] annul [the statute] and [render] it superfluous and useless." *Pillow v. Roberts*, 54 U.S. (13 How.) 472, 476 (1851) (Grier, J.). Dean Roscoe Pound concluded that such "ingenious and astute" constructions (1) "tend[ed] to bring law into disrespect; (2) . . . subject[ed] the courts to political pressure; [and] (3) . . . invite[d] an arbitrary personal element in judicial administration." III R. Pound, *Jurisprudence* 488 (1959). It threatened, he found, to make "laws . . . worth little" and to "break down" the "legal order" itself. *Id.* at 490.

[66] *Mobil Oil Exploration v. United Distribution Co.*, 111 S. Ct. 615, 623 (1991) (since " 'any' encompasses 'all' " . . . the statute is clear and unambiguous [and] that is the end of the matter . . . ") (citing *Sullivan v. Stroop*, 110 S. Ct. 2499, 2502 (1990)); *Affiliated Ute Citizens*, 406 U.S. at 151 ("proscriptions . . . are broad and by repeated use of the word 'any', are obviously meant to be inclusive").

[67] *See* 15 U.S.C. §§ 78ccc(a), (b); S. Rep. No. 1218, 91st Cong., 2d Sess. 5 (1970); H.R. Rep. No. 1613, 91st Cong., 2d Sess. 15 (1970).

section 1343 (relating to wire fraud)" and "any offense involving . . . fraud in the sale of securities." 18 U.S.C. § 1961(4). "Means" is used in the sense of this much, no more and no less; that is, equivalence.[68] The plain text of RICO, therefore, does not impose a "purchaser or seller" limitation on "victim."[69] If any ambiguity is present, the Liberal Construction Clause precludes frustrating the statute's remedial purposes. "Indeed, if Congress' liberal-construction mandate is to be applied anywhere, it is in Section 1964, where RICO's remedial purposes are most evident."[70] "[T]he plaintiff only has standing if . . . he has been injured in his business or property by the conduct constituting the violation. . . . But the statute requires no more than this."[71] Since the civil claim for relief under RICO is express, additional standing limitations on "victim" are improper.[72] "[T]he Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability."[73]

Nevertheless, the Fourth Circuit in *International Data Bank v. Zepkin*[74] held otherwise. *Zepkin* misreads RICO, ignores its statutory scheme, fails to examine its legislative history, and reflects bad policy.

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[68] *See Sedima*, 473 U.S. at 496 n.14; *Helvering v. Morgan's Inc.*, 293 U.S. 121, 125 n.1 (1984).

[69] As in the instance of Section 16(b) of the 1934 Act, "Congress intended to grant enforcement standing of considerable breadth." *Gollust v. Mendell*, 111 S. Ct. 2173, 2179 (1991).

[70] *Sedima*, 473 U.S. at 491 n.10.

[71] *Id.* at 496-97.

[72] *Compare Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 748-49 (1975) (implied claim), *reh'g denied*, 423 U.S. 884 (1975), *with Gollust*, 111 S. Ct. at 2181 (express claim) (improper to "read any further condition [on standing] into" Section 16(b)).

[73] *Blue Chip Stamps*, 421 U.S. at 748.

[74] 812 F.2d 149, 151-52 (4th Cir. 1987).

First, *H.J. Inc.*, *Monsanto*, *Sedima*, and *Turkette* hold that RICO's text, structure, and legislative history, not silence in its text or legislative history, control its interpretation.[75] RICO must be liberally construed, and its remedial purposes enhanced, not retarded.[76] The Fourth Circuit in *Zepkin* ignores the Liberal Construction Clause and does not address 18 U.S.C. Section 1964, the statutory provision that *expressly* deals with RICO's civil claim for relief. *Zepkin* also ignores RICO's *explicit* legislative history. Indeed, Congress enacted RICO outside of the antitrust statutes precisely to avoid judicially-created standing limitations on RICO's civil remedies.[77] By reading such limitations back into RICO, the Fourth Circuit "created exactly the problems Congress sought to avoid."[78] Under Article III, a court is " 'not at liberty to imply a condition which is opposed to the explicit terms of the statute. . . . To [so] hold . . . is not to construe the Act but to amend it.' "[79]

Second, Rule 10b-5 standing limitations are inapplicable to RICO, since the implied claim for relief under Rule 10b-5

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[75] *H.J. Inc.*, 492 U.S. at 236; *Monsanto*, 491 U.S. at 608-09 ("that the legislative history is 'silent' . . . proves nothing"); *Sedima*, 473 U.S. at 495 n.13 ("congressional silence . . . cannot override the words of the statute"); *Turkette*, 452 U.S. at 591 (citing *Naftalin*, 441 U.S. at 774-775; *Culbert*, 435 U.S. at 377). *See also Moskal v. United States*, 111 S. Ct. 461, 467 (1990) (every permissible application need not appear in history); *Pension Benefit Guaranty Corp. v. LTV Corp.*, 110 S. Ct. 2668, 2677 (1990) (text not limited by examples in legislative history); *Albernaz v. United States*, 450 U.S. 333, 341-42 (1981); *Standefer v. United States*, 447 U.S. 10, 20 n.12 (1980) (improper to "permit an omission in the legislative history to nullify the plain meaning of a statute"); *Harrison v. PPG Indus., Inc.*, 446 U.S. 578, 592 (1980) ("[i]n ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark").

[76] *See, e.g., Sedima*, 473 U.S. at 497-98.

[77] *Id.* at 498.

[78] *Id.* at 499.

[79] *Fedorenko v. United States*, 449 U.S. 490, 513 (1981) (quoting *Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21, 38 (1934)) (brackets and ellipses in original).

is designed to enforce the *civil* standards of the securities statutes, and RICO's private enforcement mechanism is designed to enforce the *criminal* standards of the securities statutes, where aggravating factors are present, including the presence of an "enterprise" and a "patterned" violation occurs.[80] Under *United States v. Naftalin*[81] and *SEC v. National Sec., Inc.*,[82] the purchaser-seller limitation is inapplicable in criminal prosecutions or Commission civil enforcement actions.[83] "[T]he terms 'purchase' and 'sale' [in Section 10(b)] are relevant only to the question of statutory coverage."[84] As such, they deal with "wrong," not "victim," "injury," or "cause." When it enacted RICO, Congress understood that this language meant "wrong."[85] As such, it does not serve as a basis to impose a purchaser or seller limitation on "victim," "injury" or "cause" today.

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[80] *See Agency Holding Corp.*, 483 U.S. at 150 ("enterprise" and "pattern" unknown to common law), 153 (RICO is "sui generis").

[81] 441 U.S. at 774 n.6.

[82] 393 U.S. at 467 n.9 (*Birnbaum* doctrine not relevant to suit by Commission; "purchase" and "sale" deals only with "statutory coverage," not "standing" to sue).

[83] *See, e.g., United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981) ("It is only because the judiciary . . . created a private cause of action . . . that standing . . . has become a pivotal issue") *cert. denied*, 464 U.S. 863 (1983); *United States v. Charnay*, 537 F.2d 341, 349 n.11 (9th Cir.) ("In a criminal prosecution, the standing problem is, of course, not present and Rule 10b-5 is applicable if the conduct charged falls within the Rule's prohibitions."), *cert. denied*, 429 U.S. 1000 (1976). SIPC, too, should not be so bound. *See* discussion *infra* n.252.

[84] *National Sec.*, 393 U.S. at 467 n.9. The failure of Holmes and the amici to cite or to try to distinguish the holding of *National Securities* and this unequivocal language is telling. "Judicial gloss" becomes part of the statute. *Reves v. Ernst & Young*, 110 S. Ct. 945, 956 (1990) (Stevens, J., concurring) (quoting *Shearson*, 482 U.S. at 268). Stare decisis, strongest in the statutory field, requires adherence to such an interpretation. *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 110 S. Ct. 2759, 2768 (1990).

[85] *Cannon v. University of Chicago*, 441 U.S. 677, 696-97 (1979) ("always appropriate to assume that our elected representatives . . . know the law").

RICO did not incorporate Section 10(b) and Rule 10b-5; it incorporated Section 32(a) (15 U.S.C. § 78ff(a)), the criminal provisions of the 1934 Act. " '[O]ffense . . . punishable' . . . obviously refers to [the] criminal" provisions.[86] Plaintiffs under RICO, especially public benefit corporations like SIPC, act as " 'private attorneys general' on a serious national problem for which public prosecutorial resources are deemed inadequate."[87] Had Congress wanted to impose standing limitations on RICO, it had only to add appropriate language.[88] Congress was aware of the overlap between RICO and the securities statutes.[89] Accordingly, forcing civil RICO into a purely *private* law model, as the Fourth Circuit did in *Zepkin*, misconceives the important *public* law functions of RICO's private enforcement mechanism.[90]

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[86] *Trane Co. v. O'Connor Sec.*, 718 F.2d 26, 29 (2d Cir. 1983). Merely *negligent* conduct or *strict* liability, for which a civil claim for relief may be possible under the securities acts, does not fall within RICO. *See Aaron v. SEC*, 446 U.S. 680, 701-02 (1980) (intent to defraud rather than negligence in violations of § 17 (a) (1) of 1933 Act, § 10(b) of the 1934 Act, but not when engaging in untrue statements or omissions or transactions that operate as a fraud under § 17(a) (2) and § 17(a) (3) of the 1933 Act). *See also Virginia Bankshares, Inc. v. Sandberg*, 59 U.S.L.W. 4887, 4892-93 (1991) (substantive objectives distinguished from self-help enforcement under Section 14(a)); *Gollust*, 111 S. Ct. at 2178-79 (liability distinguished from who may sue under Section 16(b)).

[87] *Agency Holding*, 483 U.S. at 151. *See also Shearson*, 482 U.S. at 241; *Sedima*, 473 U.S. at 493 ("private attorney general provision designed to fill prosecutive gaps").

[88] *Turkette*, 452 U.S. at 581 ("easily narrowed the sweep . . . by inserting a single word"); *Sedima*, 473 U.S. at 489. Under RICO, as under Section 16(b) of the 1934 Act, Congress *expressly* adopted a broad private enforcement mechanism. Restriction beyond the text is, therefore, improper. *Gollust*, 111 S. Ct. at 2179 ("The terms of § 16(b), read in context, thus provide standing of signal breadth, expressly limited only by conditions existing at the time an action is begun.").

[89] *Civil Fraud Action* at 272-73. *See* discussion *infra* n.129.

[90] *See generally* Chayes, *Foreword: Public Law Litigation and the Burger Court*, 96 Harv. L. Rev. 4, 5 (1982); *id.* at 8-26; Chayes, *The Role of the Judge in Public Law Litigation*, 89 Harv. L. Rev. 1281 (1976).

The District Court here also read the purchaser-seller limitation into the mail and wire fraud offenses.[91] No language in these statutes, however, remotely warrants reading such a limitation into them.[92] The two statutes prohibit "schemes to defraud" that utilize the mails or interstate wire communications.[93] The phrase "scheme to defraud" is not circumscribed by common law-type limitations.[94] The language was drafted in a "sufficiently general" fashion to apply

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[91] The Ninth Circuit did not reach the purchaser-seller issue under the mail and wire fraud offenses, although it was briefed and argued to the Court. The issue is within the grant of this Court's Writ of Certiorari, *Brown v. Socialist Workers '74 Campaign Comm.*, 459 U.S. 87, 94 n.9 (1982), and this Court may affirm the Ninth Circuit's decision on an independent ground not relied upon below, particularly where it was briefed and argued. *Dandridge v. Williams*, 397 U.S. 471, 475 n.6 (1970).

[92] Nor does *Zepkin* address standing under the mail and wire fraud statutes, as it only involved Rule 10b-5. 812 F.2d at 151 (standing under other claims not decided).

[93] *Compare Pereira v. United States*, 347 U.S. 1, 8-9 (1954), *with Stokes v. United States*, 157 U.S. 187, 188-89 (1895). The two statutes, because they "share the same language," are read together. *Carpenter v. United States*, 484 U.S. 19, 25 n.6 (1987).

[94] *Durland v. United States*, 161 U.S. 306, 312-14 (1896). Had Congress intended to codify the common law tort of "deceit" or the common law crimes of "larceny by trick or false pretenses," it would have employed common law terminology; it did not; Congress, therefore, intended to adopt a broader concept. *See, e.g., United States v. Turley*, 352 U.S. 407, 411-12 (1957) ("steal" not limited to "larceny"). *Compare* 1 J. Bishop, *Commentaries on the Criminal Law* §§ 565-90 (7th ed. 1882) (setting out technical requirements for property crimes such as embezzlement and false pretenses); 2 W. Lafave & A. Scott, *Criminal Law* 327-409 (2d ed. 1986) (same); Pearce, *Theft by False Promises*, 101 U. Pa. L. Rev. 967 (1953) (same); T. Cooley, *A Treatise on the Law of Torts* 474-75 (1st ed. 1879) (setting out requirements for common law action for deceit). Indeed, decisions and treatises of the time refer to the common law action for misrepresentation not as "fraud" but as "deceit." *See, e.g.*, J. Bishop, *Commentaries on the Non-Contract Law* 132-44 (1889); T. Cooley, *supra*, at 474-75; 1 E. Jaggard, *Hand-Book of the Law of Torts* 558-602 (1895); F. Pollock, *A Treatise on the Law of Torts*, 348-88 (1894). In contrast, the term "fraud," when used alone, signified a much broader range of overreaching conduct. M. Bigelow, *The Law of Fraud*

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to a broad range of schemes.[95] It includes future facts as well as present facts;[96] it also includes promises made with an intent not to perform.[97] It is not limited to misrepresentation; it includes the misappropriation of confidential information, that is, embezzlement.[98] "A comprehensive definition of 'scheme or artifice to defraud' need not be undertaken. The phrase is a broad one and extends to a great variety of transactions."[99] But its focus has always been on " 'wronging one in his property rights by dishonest methods or schemes' and [it] 'usually signif[ies] the deprivation of something of

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3-4, 190-92 (1877); T. Cooley, *supra*, at 473-74, 508-30; 2 F. Hilliard, *The Law of Torts* 74 (1874). *See also* 1 *Bouvier's Law Dictionary* 530 (1897) ("[t]o defraud is to withhold from another that which is justly due him, or to deprive him of a right by deception and artifice"); W. Anderson, *A Dictionary of Law* 474 (1893). *See also Haas v. Henkel*, 216 U.S. 462, 479-80 (1910); *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924); *Dennis v. United States*, 384 U.S. 855, 860-61 (1966).

[95] *See, e.g., United States v. Maze*, 414 U.S. 395, 399 n.4 (1974) (application upheld to credit cards, a device not in existence in 1872).

[96] *Durland*, 161 U.S. at 312-14.

[97] *United States v. Comyns*, 248 U.S. 349, 353 (1919).

[98] *Carpenter*, 484 U.S. at 27. "[I]t is impossible for a person to embezzle the money of another without committing a fraud upon him." *Grin v. Shine*, 187 U.S. 181, 189-90 (1902). In enacting RICO, Congress focused on organized crime stealing stock from brokers, which is then usually used to obtain loans from banks. *See* S. Rep. No. 617, 91st Cong., 1st Sess. 77 (1969). If purchaser-seller limitations are read into RICO in the securities *and* mail fraud areas, they would permit the defrauder banker to sue, but not the victimized broker. It is improper to *confine* the general language of a statute to facts mentioned in its legislative history. *Harrison*, 446 U.S. at 592. Holmes and the amici would *exclude* from the general language of RICO facts mentioned in its legislative history.

[99] *Fasulo v. United States*, 272 U.S. 620, 628 (1926). *See* Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 772 (1980): "During the past century, both Congress and the Supreme Court have repeatedly placed their stamps of approval on expansive use of the mail fraud statute. Indeed, each of the five legislative revisions of the statute has served to enlarge its coverage." The number, of course, is now six. *See* 18 U.S.C. § 1346 (1988) (legislatively setting aside *McNally v. United States*, 483 U.S. 350 (1987)).

value by trick, deceit, chicane or overreaching.' "[100] As this Court observed in *Donaldson v. Read Magazine, Inc.*:[101]

> [The mail fraud statute and others like it] have been regularly enforced by the executive officers and the courts for more than half a century. They are now part and parcel of our governmental fabric.

Finally, nothing in the securities statutes "repeal[ed] by implication" the mail or wire fraud statutes.[102] This Court teaches that the "two can exist and be useful, side by side."[103] Accordingly, neither mail nor wire fraud, as each is incorporated into RICO, is limited by a purchaser-seller limitation.[104]

[100] *Carpenter*, 484 U.S. at 27 (quoting *McNally*, 483 U.S. at 358 (quoting *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924))). *See also Fasulo*, 272 U.S. at 627 ("something of value by trick, deceit, chicane or overreaching."). The only substantive area carved out of the concept of "scheme to defraud" by this Court is violence. *Id.* at 628.

[101] 333 U.S. 178, 190 (1948).

[102] *Edwards*, 312 U.S. at 484.

[103] *Id.*

[104] Difficulties arise, however, when parties or courts "confus[e] mail [or wire] fraud with common law fraud." *Armco Indus. Credit Corp. v. SLT Warehouse*, 782 F.2d 475, 481 (5th Cir. 1986). The tendency is to restrict "defraud" to deceit-like elements. Neither misrepresentation, omission, materiality, nor detrimental reliance plays any role in the jurisprudence of mail or wire fraud. *See, e.g., L. W. Laird v. Integrated Resources, Inc.*, 897 F.2d 826, 839 n.53 (5th Cir. 1990) (no materiality or reliance for mail or wire fraud). Accordingly, the suggestion that common law-type restrictions should be read into "scheme to defraud" is inconsistent with this Court's jurisprudence. Following *Durland*, the circuits also developed, as mandated, their "scheme to defraud" jurisprudence outside of the framework of common law deceit. *See, e.g., Atlas Pile Driving Co. v. DiCon Financial Co.*, 886 F.2d 986, 991 (8th Cir. 1989) (cheating subcontractors meets mail fraud and RICO). It is not necessary to have a misrepresentation to have a scheme to defraud. *See, e.g., Shushan v. United States*, 117 F.2d 110, 115 (5th Cir.) (bribery may serve as basis for mail fraud) ("A scheme to get money unfairly by obtaining and then betraying the confidence of another, or by corrupting one who acts for another . . . would be a scheme to defraud though no lies were told."), *cert. denied*, 313 U.S. 574 (1941); *see also Weiss v. United States*, 122 F.2d 675, 681 (5th Cir.) (contract price raised by fictitious extra charges) ("The

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C. RICO's Plain Meaning Is Supported By Its Legislative History

When "the terms of a statute [are] unambiguous, judicial inquiry is complete, except in rare and exceptional circumstances."[105] But if RICO's legislative history is examined, far from finding a "clearly expressed legislative intention to the contrary,"[106] the legislative history demonstrates that special judicial standing limitations should not be read into RICO.

RICO grew out of separate proposals made by different senators. Only after study by both Houses of Congress and the participation of governmental agencies and bar associations were the two approaches merged, the legislation extended to the full range of fraud offenses, and the legislation drafted so that inappropriate standing or proximate cause limitations

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law does not define fraud; it needs no definition; it is as old as falsehood and as versable as human ingenuity."), *cert. denied*, 314 U.S. 687 (1941). All that is required is a scheme to defraud (plus the other RICO elements) and injury to business or property proximately caused by the scheme. Reliance by the victim may be a *sufficient* showing for proximate cause, but it is not a *necessary* showing. *See, e.g., Taffet v. Southern Co.*, 930 F.2d 847, 857 (11th Cir. 1991) (fraud on utility gives rise to RICO claim by rate payers); *Environmental Tectonics v. W. S. Kirpatrick, Inc.*, 847 F.2d 1052, 1067 (3d Cir. 1988) (fraud on government gives rise to RICO claim by losing bidder), *aff'd on other grounds*, 110 S. Ct. 701 (1990). Even the common law did not go that far. *See, e.g., Bohannon v. Wachovia Bank & Trust Co.*, 210 N.C. 679, 188 S.E. 390 (1936) (testator deceived into disinheriting plaintiff); *Mitchell v. Langley*, 143 Ga. 827, 85 S.E. 1050 (1915) (holder of life insurance policy fraudulently induced to change beneficiaries). *See also Schmuck v. United States*, 489 U.S. 705, 711-12, *reh'g denied*, 490 U.S. 1076 (1989) (mail fraud prosecution upheld where misrepresentation not made to individual who suffered loss). *See generally Equitable Relief* at 571 n.194 (deceit jurisprudence developed in atmosphere of discredited *laissez faire* and *caveat emptor*), 587 n.238 (inapplicability of common law limitations).

[105] *Demarest v. Manspeaker*, 111 S. Ct. 599, 604 (1991).

[106] *Kaiser Aluminum & Chemical Corp. v. Bonjorno*, 110 S. Ct. 1570, 1575 (1990) (citing *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). *See also Turkette*, 452 U.S. at 580 (quoting *Consumer Product Safety Comm'n*).

would not circumscribe its private enforcement mechanism.[107]

The process began in 1951 when the Kefauver Committee disclosed organized crime's infiltration into legitimate business.[108] By 1960, the criminal infiltration of labor unions was documented by the McClellan Committee.[109] Then, the McClellan Committee exposed the structure of the Mafia or LaCosa Nostra,[110] which led to the introduction in the 89th Congress of S. 2187 by Senator John L. McClellan.[111]

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[107] This history is traced in *Goldsmith on RICO* at 776-86. Professor Goldsmith found parts of the legislative history that Professor Lynch missed in *RICO: The Crime of Being a Criminal* (Parts 1-4), 87 Colum. L. Rev. 661, 920 (1987). *See also Basic Concepts* at 1014-21 (general legislative history); *Civil Fraud Action* at 249-80 (detailed review of legislative history); Note, *Functions of RICO Enterprise Concept*, 64 Notre Dame L. Rev. 646, 647-54 (1989) (detailed review of legislative history).

[108] *Basic Concepts* at 1014 n.21 (Senate reports cited).

[109] *Basic Concepts* at 1014 (Senate reports cited).

[110] *Id.* at 1015 (Senate reports cited).

[111] S. 2187, 89th Cong., 1st Sess. (1964). Section 1 of the bill included "Findings and Declaration of Fact;" they foreshadow "Statement of the Findings and Purpose" in Pub. L. No. 91-452, 84 Stat. 922. Section 2(a) of the bill prohibited "knowingly . . . becom[ing] . . . a member of (1) the Mafia or (2) any other organization" having as its purpose engaging in designated offenses. Criticism on constitutional grounds by Attorney General Nicholas de Katzenbach of the "membership approach" of S. 2187 led Senator McClellan to take a different approach in drafting RICO. *See Criminal Laws and Procedures: Hearings before the Subcomms. on Crim. Laws and Proc. of the Sen. Judiciary Comm.*, 89th Cong., 2d Sess. 32 (1966) (testimony of Attorney General Katzenbach). *See also id.* at 306-07 (Report of Association of the Bar of the City of New York criticizing S. 2187). "By focusing more on conduct, RICO sought to rectify the constitutional problems raised by S. 2187." *Goldsmith on RICO* at 783 n.70. S. 2187 also indicates that Senator McClellan saw his efforts as aimed at more than the Mafia. *See* Commission on Review of National Policy Toward Gambling, *Gambling in America* 181-82 (1976) (Stat. of Sen. McClellan) ("[I]n none of the hearings or in the processing of legislation in which I have been involved has the term [organized crime] been used in [a] circumscribed fashion [limited to the Mafia].").

The Katzenbach Commission continued the efforts in its studies that culminated in its 1967 Report.[112] Following the Commission's Report, S. 2048 was introduced in 90th Congress by Senator Roman L. Hruska.[113] Senator Hruska called the Senate's attention to the "manipulation . . . of stock"[114] and expressed concern with "bankruptcy fraud."[115] Significantly, S. 2048 included the "full range of criminal and civil sanctions . . . [for] enforcement officials and . . . persons adversely affected."[116]

Senator Hruska's proposal, studied by the American Bar Association,[117] came "to grief in part precisely because it could create inappropriate and unnecessary obstacles in the way of . . . a private litigant [who] would have to contend with a body of precedent – appropriate in a purely antitrust context – setting strict requirements on questions such as 'standing to sue' and 'proximate cause' ".[118] In the next

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[112] President's Comm. on Law Enforcement and Admin. of Justice, *The Challenge of Crime in a Free Society* 190 (1967). Senator McClellan's bill was carefully studied by Professor Donald R. Cressey. Cressey, *The Function and Structure of Criminal Syndicates* in Task Force Report: *Organized Crime* 25 (1967). Professor Cressey's ideas were influential in the drafting of RICO. *Civil Fraud Action* at 253 n.46; *Goldsmith on RICO* at 781-83.

[113] S. 2048, 90th Cong., 1st Sess. (1967). Companion legislation was introduced in the House by Congressman Richard Poff. H.R. 11,766, H.R. 11,268, 90th Cong., 1st Sess., 113 Cong. Rec. 1796 (1967).

[114] 113 Cong. Rec. 17,998 (1967). He also noted the presence of such influences in "mergers and acquisition" and decried those service industries, including "accounting firms," that had organized crime ties. *Id.*

[115] *Id.* at 17,999.

[116] *Id.* (Stat. of Sen. Hruska). Thus, while Senator McClellan's measure focused on illicit enterprises, Senator Hruska's bill focused on licit enterprises; Senator McClellan, too, emphasized in his bill a criminal approach, while Senator Hruska emphasized in his bill a civil approach, including private enforcement. Neither bill, at this time, included the broad range of federal fraud statutes.

[117] 115 Cong. Rec. 6994-95 (1969) (text of report).

[118] *Sedima*, 473 U.S. at 498.

Congress, Senator Hruska introduced S. 1623 as a free-standing bill.[119]

Meanwhile, the Penal Reform Commission recommended a number of concepts later reflected in RICO.[120] Senator McClellan, too, introduced S. 30, the "Organized Crime Control Act of 1969."[121]

Finally, Senators McClellan and Hruska introduced S. 1861.[122] S. 1861 included criminal and civil sanctions, although, unlike S. 1623, it did not include an express private treble damage remedy.[123] Senator McClellan said that he did not want to see "imported [into the bill] the great complexity

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[119] 115 Cong. Rec. 6992 (1970).

[120] *Civil Fraud Action* at 253 n.47 ("enterprise" and "pattern of racketeering").

[121] 115 Cong. Rec. 827 (1969). In urging action on his legislation, Senator McClellan made a major speech on organized crime in which he focused on "various bankruptcy fraud techniques." 115 Cong. Rec. 5874 (1970).

[122] 115 Cong. Rec. 9567 (1969). S. 1861 contained findings similar to those in S. 30; they are now found Pub. L. No. 90-452. *Id.* at 9568. S. 1861 applied to both licit and illicit enterprises; its predicate offenses included 18 U.S.C. Section 2314 (interstate transportation of property obtained by scheme to defraud); they did not yet include bankruptcy fraud, mail or wire fraud, or securities fraud. S. 1861 introduced the Liberal Construction Clause. 115 Cong. Rec. 9571 (1969). While the findings mentioned "corruption" and "innocent investors," they did not, as yet, note "fraud."

[123] "It is likely, however, that a private cause of action would have been implied. . . . " *Civil Fraud Action* at 262 n.71. *Compare Blue Chip Stamps*, 421 U.S. at 730 ("Such a conclusion [is], of course, entirely consistent with . . . *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)") *with Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 536 (1984) *and Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 378 (1982). The current restrictive approach toward finding implied claims for relief did not become law until *Cort v. Ash*, 422 U.S. 66, 78 (1975). *See Virginia Bankshares*, 59 U.S.L.W. at 4892; *Touche Ross & Co. v. Redington*, 442 U.S. 560, 576-78 (1979).

of antitrust law enforcement."[124] The President in his "Message on Organized Crime" endorsed the treble damage concept, as did the American Bar Association.[125] As a result of recommendations of the Securities and Exchange Commission staff,[126] the federal fraud statutes were added to the provisions of S. 1861. The bill was then incorporated into Title IX of S. 30, reported out,[127] and passed by the Senate.[128]

In the House hearings, the Association of the Bar of New York City thought the bill extended too far beyond organized crime by its inclusion of securities fraud among its predicate offenses.[129] The American Bar Association, however, called for the private treble damage mechanism.[130] In the Senate, Senator McClellan applauded the Association's recommendations.[131] The House Judiciary Committee rejected the

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[124] 115 Cong. Rec. 9567 (1969). That "complexity," of course, is antitrust-type limitations on standing or proximate cause, which primarily affect private litigation. *See Civil Fraud Action* at 263 n.72.

[125] *Measure Relating to Organized Crime: Hearings Before the Subcomm. on Crim. Laws and Proc. of the Senate Judiciary Comm.*, 91st Cong., 1st Sess. 444 (reprint of President's Message), 259 (ABA testimony) (1969).

[126] *Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law* 99 n.130 (1985).

[127] S. Rep. No. 617, 91st Cong., 1st Sess. 21-22 (1969). As amended by the Committee, the findings expressly mentioned "fraud" and "racketeering activity" included mail fraud, wire fraud, transportation fraud, bankruptcy fraud, and securities fraud.

[128] 116 Cong. Rec. 972 (1970).

[129] *Organized Crime Control Act: Hearing on S. 30 Before Subcomm. No. 5 of the House Judiciary Comm.*, 91st Cong., 2d Sess. 294, 329 (1970). Similar testimony was given by the American Civil Liberties Union and the New York County Lawyers Association. *Id.* at 401, 499.

[130] *Id.* at 543-44 (Testimony of President-elect Edward L. Wright).

[131] In particular, he commented that the suggestion of a treble damage claim for relief was a "constructive contribution." 116 Cong. Rec. 25,190 (1970) (Stat. of Sen. McClellan).

objections of the Association of The Bar of New York City and adopted the recommendations of the American Bar Association.[132]

Over the objections of Committee members – the bill went beyond organized crime,[133] and it included a private treble damage provision[134] – the legislation passed the House,[135] and the Senate took up the bill.[136] Senators applauded the American Bar Association[137] and the treble damage mechanism.[138] The Senate passed the legislation,[139] and the President signed it.[140]

Nothing in this legislative process can be plausibly cited to support reading into RICO's *express* private enforcement mechanism the *implied* limitations of the securities statutes. Congress *deliberately* fashioned an express claim for relief, *mandated* its liberal construction, and sought to draft it *precisely* so that such restrictive standing or proximate cause limitations would *not* circumscribe it.

The "views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one."[141] "[S]tatutes

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[132] H.R. Rep. No. 1549, 91st Cong., 2d Sess. 16 (fraud predicates), 17-18 (private enforcement mechanism) (1970).

[133] 116 Cong. Rec. 35,204 (1970) (Stat. of Rep. Mikva). *See also* H.R. Rep. No. 1549, 91st Cong., 2d Sess. 187 (1970).

[134] 116 Cong. Rec. at 35,205 (Stat. of Rep. Mikva). Fearing that treble damage suits might be used to injure legitimate businesses, Congressman Abner J. Mikva (now Judge) proposed an amendment establishing penalties for their "malicious use." It failed. 116 Cong. Rec. 35,332 (1970).

[135] *Id.* at 35,363.

[136] *Id.* at 36,280.

[137] *Id.* at 36,293 (Stat. of Sen. McClellan).

[138] *Id.* at 36,296 (Stat. of Sen. Dole). Senator Dole had been a supporter of RICO-type legislation when Congressman Poff originally introduced it in the House in 1967. 113 Cong. Rec. 17,948 (1967).

[139] 116 Cong. Rec. 36,296 (1970).

[140] *Id.* at 37,264.

[141] *Russello*, 464 U.S. at 26 (quoting *Jefferson County Pharmaceutical Ass'n v. Abbott Laboratories*, 460 U.S. 150, 165 n.27 (1983)).

are construed by the courts with reference to the circumstances existing at the time of the passage."[142] Nevertheless, subsequent legislative developments, since they "confirm"[143] a construction of the statute that does not include a purchaser-seller limitation, are entitled to "significant weight."[144]

Efforts to "reform" RICO after *Sedima* focused on Congress.[145] The securities industry[146] and the accounting profession[147] played leading roles. A major effort was made to insert a purchaser-seller limitation.[148] Such legislation was reported in 1990.[149] Writing special rules for one industry, however, is controversial.[150] The bill failed to pass, and the proposed reform no longer provides special rules for specific industries.[151] The securities industry and the accounting profession ought not now obtain in the judicial forum a limitation on RICO that they were unsuccessful in obtaining in the political forum.

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[142] *United States v. Wise*, 370 U.S. 405, 411 (1962).

[143] *See Andrus v. Shell Oil Co.*, 446 U.S. 657, 666 n.8 (1980).

[144] *Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 596 (1980).

[145] *See, e.g., Oversight on Civil RICO Suits: Hearings before the Sen. Comm. on the Judiciary*, 99th Cong., 1st Sess. (1985) (hereinafter "1985 Hearings").

[146] *Id.* at 633.

[147] *Id.* at 248.

[148] *See generally* 133 Cong. Rec. H8835-42 (daily ed. Oct. 10, 1987) (Stat. of Rep. Conyers).

[149] S. Rep. No. 269, 101st Cong., 2d Sess. 20 (1990) (reporting S. 438).

[150] *See, e.g.*, 134 Cong. Rec. E3720 (daily ed. Oct. 21, 1988) (Stat. of Rep. Conyers) ("I see no reason to give the likes of Boesky or Butcher in their stock fraud or bank fraud activities a special bill of relief.").

[151] *See* H.R. Rep. No. 975, 101st Cong., 2d Sess. 8 (1990) (reporting H.R. 5111) (S. 438 rejected because it "would go too far in certain respects and give the appearance of favoring certain industries such as the commodities, securities and savings and loan industries which are currently the subject of major fraud investigation."). *See also* Wall St. J., May 2, 1991, at 6, col. 1 (noting reporting of H.R. 1717, identical to H.R. 5111).

D. Holmes' Other Standing Arguments Are Not Within The Grant Of Certiorari And Are Meritless.

Holmes and the amici go beyond this Court's grant of Certiorari. They conflate aspects of different standing doctrines.[152] The "doctrine of standing in the federal courts" is a complex intermixture of prudential rules formulated by the judiciary, statutory law, and constitutional limitations.[153] While Congress may not "abrogate the Art. III minima," it "may, by legislation, expand standing to the full extent permitted by Art. III" without regard to "prudential standing rules."[154] Under Section 1964(c), standing, therefore, may be used in several different ways: "victim" ("any person"), "injury" ("in his business or property"), and "cause" ("by reason of").[155] Nothing Holmes or the amici offer in support of their "by reason of" or their "in the business or property" arguments[156] warrants departure from this Court's practice in this area.[157]

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[152] *Petitioner's Brief* at 9-16 (injury), 16-21 (cause) (hereinafter "Holmes Brief"); *Brief of Arthur Anderson & Co., et al.* at 9-18 (hereinafter "Firms' Brief"); *Brief of American Institute of CPA's* at 16-17 (hereinafter "Institute's Brief").

[153] *See generally Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91, 99-100 (1979).

[154] *Id.* (quoting *Warth v. Seldin*, 422 U.S. 490, 501 (1975)).

[155] The most succinct, perceptive, and discriminating lower court treatment of "standing" under RICO is found in Judge Thornberry's opinion in *Ocean Energy II, Inc. v. Alexander & Alexander, Inc.*, 868 F.2d 740, 743-48 (5th Cir. 1989). *See also* Judge Scirica's review of the authorities in *In re Sunrise Sec. Litig.*, 916 F.2d 874, 878-82 (3d Cir. 1990).

[156] *See American Nat'l Bank and Trust Co. v. Haroco*, 473 U.S. 606, 608 (1985) ("Petitioners do not appear to have made this precise argument below, it was not addressed by the Court of Appeals, and it quite clearly is not included in the question presented by their petition for certiorari.")

[157] *Hecklen v. Campbell*, 461 U.S. 458, 468 n.12 (1983) (citing *McGoldrich v. Campagnie Generale Transatlantique*, 309 U.S. 430, 434-35 (1940)); *J.I. Case*

(Continued on following page)

1. The "By Reason Of" Argument Ought To Be Rejected As Not Within The Grant Of Certiorari.

Holmes and the amici suggest that SIPC cannot meet the requirement of Section 1964(c) that injury to business or property be "by reason of" a violation of Section 1962.[158] This Court, however, granted certiorari "limited to Question 1 presented by the petition".[159] These arguments, therefore, ought to be rejected.

2. The "By Reason Of" Argument Ought To Be Rejected, Since A Material Question Of Fact Was Raised As To Proximate Causation.

Holmes moved in the District Court for summary judgment and asserted a lack of a material question of fact on the causal relation between Holmes' conduct and the injuries to FSSC, Sebag, and SIPC.[160] The District Court granted the motion.[161] The Ninth Circuit reversed and found that if "Holmes conspired with [his] codefendents, and if the codefendents caused [as the District Court found for summary judgment purposes] the alleged injuries, then Holmes is legally responsible"[162] for the various injuries.

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Co. v. Borak, 377 U.S. 426, 428-29, n.3 (1964); *Irvine v. California*, 347 U.S. 128, 129-30 (1954). In particular, raising standing to sue for the first time on appeal is improper. *McCandless v. Furland*, 293 U.S. 67, 73-74 (1934) (real party in interest) ("The reason for the rule is the broad one that a defect found lurking in the record on appeal may not be allowed to defeat recovery, where the defect might have been remedied, if the objection had been seasonably raised in the trial court.").

[158] *Holmes' Brief* at 16-21; *Firms' Brief* at 9-18; *Institute's Brief* at 16-17.

[159] 111 S. Ct. 1618 (1991).

[160] C.R. 1281.

[161] Pet. App. 41a.

[162] 908 F.2d at 1468-69.

Section 1964(c) provides recovery for injury to business or property "by reason of" a violation of Section 1962. " '[B]y reason of' . . . simply imposes a proximate cause requirement on plaintiffs."[163] In *Haroco*, the Seventh Circuit aptly observed, "This causation requirement might not be subtle, elegant or imaginative, but . . . it is based on a straightforward reading of the statute as Congress intended it to be read."[164] As such, a plaintiff, to recover under RICO, need only prove a violation of section 1962 and an injury proximately resulting from some or all of the activity comprising the violation(s).[165]

"By reason of" language appears in other federal statutes.[166] Its reading, too, is not subtle. In *Mead v. Retail Clerks Int'l Ass'n Local Union No. 830*,[167] the Ninth Circuit, for example, considered the "by reason of" language in Section 303 of the Labor Management Relations Act of 1947,[168] which is relevant here, since it was also "drawn . . . from the treble damage provision of the Clayton Act" and, like RICO, "was enacted as an alternative to" using the antitrust laws directly.[169] In *Mead*, the Court held that injury "occur[s] 'by reason of' particular unlawful conduct if such conduct 'materially contributed' to the injury . . . or was a 'substantial factor' in bringing it about. . . . "[170] The Ninth Circuit's

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[163] *Haroco*, 747 F.2d at 398.

[164] *Id.* at 398. *Accord Zervas v. Faulkner*, 861 F.2d 823, 832-35 (5th Cir. 1988); *Brandenburg v. Seidel*, 859 F.2d 1179, 1187-90 (4th Cir. 1988); *Sperber v. Boesky*, 849 F.2d 60, 64 (2d Cir. 1988).

[165] *Marshall & Illsley Trust Co. v. Pate*, 819 F.2d 806, 809 (7th Cir. 1987).

[166] *See, e.g.*, 12 U.S.C. § 1975; 15 U.S.C. § 72; 19 U.S.C. § 1671d(b) (1); 22 U.S.C. § 2399b(a); 29 U.S.C. § 186(c); 41 U.S.C. § 119; 46 U.S.C. § 1227.

[167] 523 F.2d 1371 (9th Cir. 1975).

[168] 61 Stat. 158 (1947).

[169] 523 F.2d at 1376.

[170] *Id. Accord Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 23-24 (2d Cir. 1990). Proximate cause is usually an issue for the jury. W. Prosser & R. Keeton, *The Law of Torts* § 41 (5th ed. 1984).

causation holding, therefore, is consistent with the language of the statute, this Court's decisions in *Sedima*[171] and *Haroco*,[172] and general jurisprudence.[173] The decision of the Ninth Circuit should be affirmed.

3. The "In His Business Or Property" Argument Ought To Be Rejected As Not Within The Grant of Certiorari.

Holmes and the amici suggest that SIPC cannot meet the requirement of Section 1964(c) that injury by reason of a violation of Section 1962 be to "his business or property."[174] This argument is raised here for the first time. It, too, ought to be rejected.[175]

4. The "In His Business Or Property" Argument Ought To Be Rejected, Since SIPC Has Such Standing Under Well-Settled Principles Of Law.

SIPC and its Trustees sought recovery for injury in the form of damages for advances made to the Trustees for the payment of net equity claims made to customers; for damages to that portion of the fund of customer property to which

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[171] 473 U.S. at 493-99 (rejecting racketeering injury limitation). Indeed, to the degree that Holmes and the amici would add "purchaser-seller" as words of limitation to the text of Section 1964(c) ("by reason of, *but only against a purchaser or seller*"), their argument is little more than a variation of the racketeering injury limitation that this Court squarely rejected in *Sedima*.

[172] 473 U.S. at 609 ("To the extent petitioners' argument is a variation on the racketeering injury concept at issue in *Sedima* . . . , it is inconsistent with that decision. . . . [and] we reject [it].").

[173] *See* Blakey, *Foreword: Debunking RICO's Myriad Myths*, 64 St. John's L. Rev. 701, 721 n.111 (1990) (statutes and cases collected on civil liability flowing from conspiracy).

[174] *Holmes' Brief* at 9-16; *Firms' Brief* at 9-18; *Institute's Brief* at 16-17.

[175] *See Haroco*, 473 U.S. at 608.

SIPC was subordinated to the claims of customers; for damages for costs and expenses of administration of liquidation (including those paid with estate assets and those paid with advances by SIPC); for damages to that portion of the debtors' estates available to satisfy creditor claims, subordinated lenders and shareholders; and for destruction of the businesses of the debtors.[176]

The standing of the Trustees to sue for damages to the debtors is beyond question.[177] The Trustees have a duty to bring claims for relief that are property of the debtors' estate.[178] The Trustees also have standing to sue as bailees of the customers' property.[179] Similarly, the standing of SIPC as "a party in interest as to all matters" is specifically conferred by statute.[180] Finally, SIPC is granted subrogation rights for

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[176] J.A. at 56-57.

[177] *See, e.g., In re Sunrise*, 916 F.2d at 889; *Kompe v. Monitor Intermediaries, Inc.*, 785 F.2d 1443, 1444 (9th Cir. 1986); *Schacht v. Brown*, 711 F.2d 1343, 1346-50 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983).

[178] *See, e.g., SIPC v. Christian-Paine & Co.*, 755 F.2d 359, 360-61 (3d Cir. 1985).

[179] *Redington v. Touche Ross & Co.*, 592 F.2d 617, 624-25 (2d Cir. 1978) ("The trustee [may sue] . . . as a bailee of [the] customers' property . . . on behalf of such customers as have not been fully reimbursed by SIPC."), *rev'd on other grounds*, 442 U.S. 560 (1979), *on remand*, 612 F.2d 68 (2d Cir. 1979). The single and separate fund in possession of the debtor "is not composed of the assets of the debtor, but, rather, property of the customers." *SEC v. Albert & Maguire Sec. Co., Inc.*, 560 F.2d 569, 574 (3d Cir. 1977). As such, the "trustee is charged with administering the fund to provide maximum distribution to customers [and] . . . the trustee [may] take an assignment of the claim in order to avoid an unnecessary drain on the fund." *Id. See also Richardson v. Shaw*, 209 U.S. 365, 374-80 (1907) (customer is owner, while broker is pledgee); *Gorman v. Littlefield*, 229 U.S. 19, 23-24 (1912) (share held by broker, but owner is customer).

[180] Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 7(c), 92 Stat. 249, 259 (1978) (codified at 15 U.S.C. § 78eee(d) (1988)). The 1978 amendment was enacted so that SIPC might "carry out its proper functions as the entity charged with the administration of SIPA . . . and as the party which, to a large extent, is responsible for overseeing the funds available for use in a liquidation proceeding." S. Rep. No. 763, 95th Cong., 2d Sess. 11 (1978);

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its money paid to customers for customer claims against the debtor,[181] and it has common law rights of subrogation for its money paid to customers for customer claims against third parties.[182] Double recovery is precluded, since credit must be given for any SIPC funds paid, if the customer sues third parties in his own right.[183]

Holmes' discussion of corporations and shareholders, employees, and creditors, counties and taxpayers, insured and

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H.R. Rep. No. 746, 95th Cong., 1st Sess. 27 (1977) (identical language). The language "was drawn from section 208 of Chapter X of the Bankruptcy Act." *Id.* The legislative history cited *SEC v. Krentzman*, 397 F.2d 55 (5th Cir. 1968), that gave broad scope to Section 208. Congress intended SIPC's standing as a party in interest, therefore, to be given broad scope. As such, SIPC's standing, as a party in interest, extends to initiating suits. *See, e.g., Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1362-63 (5th Cir.), *reh'g denied*, 801 F.2d 398 (1986); *Matter of Marin Motor Oil, Inc.*, 689 F.2d 445, 456 n.11 (3d Cir. 1982), *cert. denied*, 459 U.S. 1206 *and* 1207 (1983). While the SIPA program resembles a bankruptcy, SIPA "create[d] a new form of liquidation, applicable only to member firms." *SIPC v. Barbour*, 421 U.S. 412, 416 (1975).

[181] SIPA was drafted without recognizing specifically SIPC's other rights. 84 Stat. 1651 (1970). The 1978 amendment, however, expressly preserved such rights. 92 Stat. 266 (1978).

[182] *See, e.g., Redington*, 592 F.2d at 624 ("SIPC is subrogated to the right of action . . . of brokers' customers against third parties such as accountants."); *SEC v. Albert & Maguire*, 560 F.2d at 574 ("Upon payment of benefits, the trustee and SIPC stand not in the shoes of the debtor . . . but, rather, in those of the customer . . . [and] SIPC becomes subrogated to the customer's rights against third parties."). *See also id.* at 573 (trustee may recover on customers' claims against third parties, since it would augment the single and separate fund and additional money would become available to satisfy claims of all customers); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 137-40, 144 (7th Cir.) (trustee under pre-SIPA law may bring Rule 10b-5 claim against third party), *cert. denied*, 396 U.S. 838 (1969); *Hooper v. Mountain State Sec. Corp.*, 282 F.2d 195, 207 (5th Cir. 1960) (trustee in bankruptcy may sue third parties), *cert. denied*, 365 U.S. 814 (1961).

[183] *See, e.g., Krusi v. Bear, Stearns & Co.*, 144 Cal. App. 3d 664, 676-78, 192 Cal. Rptr. 793, 800-02 (1983). SIPC, too, is "an indispensable party" in such suits. *Id.* at 677, 192 Cal. Rptr. at 801 (citing *Bank of Orient v. Superior Court*, 67 Cal. App. 3d 588, 594-96, 136 Cal. Rptr. 741, 744-46 (1977)).

insurer, and unions and union members[184] is new to this litigation and irrelevant.[185] In particular, it is suspect, as it does not deal with the statutory and common law relationship between customers and broker-dealers in the unique liquidation provided for by SIPA. Holmes confines his discussion to a footnote,[186] which lacks authority, much less a detailed treatment of the precedents.[187] The "in his business or property" argument of Holmes should be rejected on the merits.

E. Holmes' Policy Arguments Are A Matter For Congress And Are Meritless.

1. Policy Considerations Are For Congress.

"The short answer [to the policy arguments of Holmes and the amici] is that Congress did not write the statute that way."[188] "[W]isdom or unwisdom . . . is to be put aside in the process of interpreting a statute."[189] "Resolution of the pros

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[184] *Holmes' Brief* at 9-16.

[185] It is misleading as well. While the general rule is that creditors lack standing to sue for injury to the debtors, where the creditor is a victim of the fraud, as here, in the case of the owners of the Target Securities, such creditors have standing in their own right to sue under RICO. *See, e.g., Ashland Oil, Inc. v. Arnett*, 875 F.2d 1271, 1280 (7th Cir. 1989); *Ocean Energy II*, 868 F.2d at 744-47; *Bankers Trust Co. v. Rhoades*, 859 F.2d 1096, 1100-01 (2d Cir. 1988), *cert. denied*, 490 U.S. 1007 (1989). A detailed analysis of the bases of each aspect of the damage claims must await trial on the merits. The requests, however, fall within current law. *See, e.g., Ocean Energy II*, 860 F.2d at 746-48; *Bankers Trust Co.*, 859 F.2d at 1105-07; *Alexander Grant & Co. v. Tiffany Indus. Inc.*, 770 F.2d 717, 719 (8th Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986).

[186] *Holmes' Brief* at 14 n.4. The amici do not discuss it at all.

[187] *See, e.g., SIPC v. Poirier*, 653 F. Supp. 63, 65-66 (D. Ore. 1986) (SIPC and SIPA trustee have standing to sue third parties for RICO violations directed at liquidated firm).

[188] *Russello*, 464 U.S. at 23 (quoting *Naftalin*, 441 U.S. at 773); *Monsanto*, 491 U.S. at 611 (quoting *Naftalin*).

[189] *Rubin v. United States*, 449 U.S. 424, 431 n.8 (1981) (quoting *TVA v. Hill*, 437 U.S. 153, 194 (1978)). *See also, Airline Pilots Ass'n Int'l v. O'Neill*, 111 S. Ct. 1127, 1135 (1991).

and cons of whether a statute should sweep broadly or narrowly is for Congress."[190] "There is no argument that Congress acted beyond its power in [enacting RICO]. That being the case, the courts are without authority to restrict the application of the statute."[191] "The fact that § 1964(c) is used against respected businesses . . . is hardly a sufficient reason for assuming that the provision is being misconstrued. . . . [If this is a] defect . . . its correction must lie with Congress."[192] "[R]ewriting [RICO] is a job for Congress, if it is so inclined, and not for this Court. There is no more room in RICO's 'self-consciously expansive language and overall approach' for the imposition of a . . . [purchaser or seller] limitation than for [an organized crime limitation or] the amorphous 'racketeering injury' requirement. . . . "[193]

This Court properly declined to add "organized crime" to "any person"[194] and "pattern"[195] and "legitimate" to "enterprise"[196] in Section 1962. It declined to add "in an enterprise" to "any interest"[197] and "but not legal fees" to "property"[198] in Section 1963. Finally, it declined to add "only" to "sue"[199] and "racketeeringly" and "competitively" to "injury" and "convicted of" to "violation" in Section 1964.[200] The

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190 *United States v. Rodgers*, 466 U.S. 475, 484 (1984).

191 *Turkette*, 452 U.S. at 587.

192 *Sedima*, 473 U.S. at 499.

193 *H.J. Inc.*, 492 U.S. at 249 (quoting *Sedima*, 473 U.S. at 495, 498).

194 *Sedima*, 473 U.S. at 495 (" 'any person' – not just mobsters").

195 *H.J. Inc.*, 492 U.S. at 249 ("decline the invitation to invent a rule").

196 *Turkette*, 452 U.S. at 581 ("by inserting a single word").

197 *Russello*, 464 U.S. at 20-23 ("it presumably would have done so expressly").

198 *Monsanto*, 491 U.S. at 614 ("as presently written, cannot be read any other way").

199 *Tafflin*, 110 S. Ct. at 797 ("not free to add content").

200 *Sedima*, 473 U.S. at 488 ("language . . . gives no obvious indication . . . only after a criminal conviction), 495 ("reading of the statute belies any such requirement").

argument for the addition of "purchaser-seller" to Section 1964 should fair no better.[201] If it is a good idea, Congress should do it.

2. The Policy Considerations Are Meritless.

a. Fear Of A Flood Of New RICO Litigation Is Unwarranted.

Fear of a litigation burden[202] is not a sufficient reason to alter a statutory design,[203] but it motivates lower courts.[204] The "Litigation Floodgate Myth"[205] needs, therefore, to be put to rest.

Proponents of reform say that one quarter of all civil filings contain a RICO count.[206] Since approximately 240,000 civil cases are filed each year,[207] that would mean that RICO filings are about 60,000. Yet reported RICO filings are not much more than 1,000 each year.[208] The undercount is

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201 The argument, too, should fare no better than the "continuous ownership requirement" that this Court declined to add to the *express* standing requirement of Section 16(b) of the 1934 Act in *Gollust*, 111 S. Ct. at 2180 (rejected, since not "found in the text of the statute nor . . . [its] legislative history").

202 *Holmes' Brief* at 36; *Institute's Brief* at 3, 19-20.

203 *Tower v. Glover*, 467 U.S. 914, 923 (1984).

204 *See, e.g., McCarthy v. Pacific Loan, Inc.*, 600 F. Supp. 137, 139 (D. Haw. 1984).

205 *See Myths* at 869-73.

206 *RICO Reform Act of 1989: Hearings before Subcomm. on Crime of the House Judiciary Comm.*, 101st Cong., 1st Sess. 370 (1989) (Stat. of Rep. Rick Boucher) (hereinafter "*1989 Hearings*").

207 Director of the Admin. Office of the U.S. Courts, *Annual Report* Table S-8 at 114 (1988) (hereinafter "*1988 Report*").

208 *Myths* at 1018 (data on filings from Nov. 1985 through Oct. 1989). The number tried is hardly more than a handful. *See* Hughes, *RICO Reform: How Much is Needed?* 43 Vand. L. Rev. 639, 644 (1990) ("Of the 855 Civil RICO cases closed in 1988, 389 were dismissed and 186 settled; only fourteen went to jury trial, and only eight were tried by a court.").

passed off by critics who suggest that litigators "check other claims for relief" when they file civil RICO complaints.[209] Published civil RICO opinions in 1986 indicate, however, that 28.8% included a securities filing.[210] That year 3,059 securities filings were made.[211] As such, if the reported filings are representative of the unreported filings, not more than 10,622 civil RICO filings were made in 1986, 4.2%, not 25%.

This Court's opinion in *Sedima* is said by the securities industry and the accounting profession to have opened the "floodgate."[212] In 1985, 3,266 securities cases were filed.[213] By 1988, the number, however, had *dropped* to 2,638, falling by 19%.[214] The RICO Floodgate Myth is flatly false.[215]

Concern with court dockets was expressed by those who opposed Section 1964(c) in 1970.[216] Courts ought not now

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[209] *1989 Hearings* at 210 (Stat. of Philip A. Lacovara for Coalition for Civil RICO Reform).

[210] *Equitable Relief* at 621.

[211] *1988 Report* at 186.

[212] *1985 Hearings* at 631 (securities), 255 (accounting).

[213] *1988 Report* at 186.

[214] *Id.*

[215] The clarification of the "pattern" in *H.J. Inc.* must also be considered. Post-*H.J. Inc.* litigation establishes that "pattern" is a substantial limiting factor in the use of RICO in ordinary commercial litigation. Circuit court opinions indicate that district courts regularly grant dismissals for a failure to show a "pattern", and they are regularly affirmed on appeal. *See, e.g., Arzuaga-Collazo v. Oriental Fed. Sav. Bank*, 913 F.2d 5, 6-7 (1st Cir. 1990); *Banks v. Wolk*, 918 F.2d 418, 421-23 (3d Cir. 1990); *Menasco, Inc. v. Wasserman*, 886 F.2d 681, 684 (4th Cir. 1989); *Howell Hydrocarbons, Inc. v. Adams*, 897 F.2d 183, 190-93 (5th Cir. 1990); *American Eagle Credit Corp. v. Gaskins*, 920 F.2d 352, 354-55 (6th Cir. 1990); *United States Textiles, Inc. v. Anheuser-Busch Cos.*, 911 F.2d 1261, 1266-69 (7th Cir. 1990); *Lane v. Peterson*, 899 F.2d 737, 744-45 (8th Cir.), *cert. denied*, 111 S. Ct. 74 (1990); *Phelps v. Wichita Eagle-Beacon*, 886 F.2d 1262, 1273-74 (10th Cir. 1989); *Pyramid Secur., Ltd. v. IB Resolution, Inc.*, 924 F.2d 1114, 1116-20 (D.C. Cir. 1991).

The jurisprudence on "pattern," therefore, is firming up, and this type of litigation will not continue.

[216] H.R. Rep. No. 1549, 91st Cong., 2d Sess. 187 (1970) (dissent) (burdens the courts face in terms of case loads).

resurrect a rationale for narrowing RICO that Congress rejected.[217] No court ought now reweigh the "balance" between "opposing policy arguments,"[218] strike a new "compromise,"[219] or make an effort to rewrite this "carefully crafted piece of legislation."[220]

b. Fear Of Unjust Settlements Under RICO Is Unwarranted.

Holmes and amici present a potpourri of other policy considerations. Each may be characterized as a myth and duly labeled: The Racketeer Label Myth,[221] The Litigation Abuse Myth,[222] The Litigation Abuse Remedies Myth,[223] The Federalism Myth,[224] The Multiple Damage Myth,[225] and The Garden Variety Fraud Myth.[226]

RICO suits, with little or no merit, do not settle for extortionate amounts.[227] In fact, business people will not

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[217] *Park 'N Fly, Inc. v. Dollar Park and Fly, Inc.*, 469 U.S. 189, 200-02 (1985) (improper merely to "disagree[ ] with the balance struck by Congress").

[218] *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 623, *reh'g denied*, 439 U.S. 884 (1978).

[219] *Mohasco Corp. v. Silver*, 447 U.S. 807, 826 (1980).

[220] *Iannelli v. United States*, 420 U.S. 770, 789 (1975). *See also Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 643 (1985) (litigation is not an evil).

[221] *Myths* at 875-76.

[222] *Id.* at 877-79.

[223] *Id.* at 879-81.

[224] *Id.* at 920-24.

[225] *Id.* at 916-19.

[226] *Id.* at 881-909. Further, this case presents anything but a "garden variety fraud." *See* discussion, J.A. at 124-232 (detailing Holmes' nefarious activities).

[227] *See Holmes' Brief* at 36; *Firms' Brief* at 2-3; *Institute's Brief* at 17-18. The principal basis on which this canard rests is the *Report of the Ad Hoc Civil RICO Task Force of the ABA Section on Corporations, Banking and Business Law* 69 (1985). Two factors, however, undermine the scientific credibility of the task force report: (1) the population questioned was unrepresentative of the bar, and (2) the response rate was insufficient to warrant broad generalizations. *See* D. Huff, *How To Lie With Statistics* 11-26 (sample with built-in bias), 37-52 (sample of insufficient number) (1982). The extortionate settlement opinion was volunteered by only two of the 350 respondents as grounds for repealing RICO.

settle suits that should be settled because of the RICO count.[228] Today, plaintiffs often file "silent" RICO complaints: ones not using the term "racketeer." In fact, defendants do not pay off strike suits at more than their harassment value, no matter what the theory of the complaint. Suggestions to the contrary make little economic sense.[229]

The charge that RICO is subject to litigation abuse[230] is unsupported.[231] When the Coalition for Civil RICO Reform had to document in Congress "abusive cases," the list was an embarrassment.[232] Ronald Goldstock also conducted a study of 704 RICO cases. He concluded: "RICO cases are not resulting in unwarranted judgments for plaintiffs nor are settlements being extorted. Where abuse does exist. . . . Rule 11 sanctions appear capable of serving as punishment."[233] The

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[228] A majority of seasoned litigators in the RICO area know that adding a RICO claim to a suit does not facilitate settlement; it inhibits it, particularly when a legitimate business is involved. ABA, Criminal Justice Section, *Comprehensive Perspective on Civil and Criminal RICO Legislation and Litigation*: A Report of The RICO Cases Committee 121-23 (1985). It is difficult, too, to see how adding a RICO count to a suit with little or no merit has any effect. If a plaintiff's suit has no merit, the chance of success is zero, and zero multiplied by three (or any other number) is still zero.

[229] *See Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

[230] *Holmes' Brief* at 3-4; *Firm's Brief* at 2-3; *Institute's Brief* at 17-18.

[231] Goldsmith & Linderman, *Civil RICO Reform: The Gatekeeper Concept*, 43 Vand. L. Rev. 735, 758-61 (1990).

[232] *See generally Myths* at 1021-48 (detailed analysis of list of 53 abusive cases). The list included a suit against an organized crime dominated union and a suit against an individual who had been convicted of extorting sexual favors and a percentage of a death benefit from a widow and her four children. *See id.* at 1046-47 (suit against figures in mob dominated union), 1043 (extortion).

[233] *1989 Hearings* at 613. Several Rules of Civil Procedure have a substantial and salutary impact on frivolous or meritless RICO litigation. *See* Fed. R. Civ. P. Rules 9(b), 11, 26, 56. These "tools are sufficient to reduce frivolous or meritless litigation." Judicial Conference of the U.S., *Reports of the Proceedings of the Judicial Conference of the United States* 56 (1983). *See also Chambers v. Nasco, Inc.*, 111 S. Ct. 2123 (1991) (inherent power to impose as sanction litigation costs on party).

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allegations of abuse are just that: allegations.[234]

Far from frustrating federalism,[235] RICO implements it.[236] Over the years, Congress, under the Commerce Clause, enacted the antitrust statutes, the money and banking statutes, labor legislation, food and drug laws, securities statutes, and

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These Rules are not only vigorously enforced, but the district courts are using a "RICO Case Statement" that requires plaintiffs to provide the court with a statement of what they expect to prove; it is then used to dismiss improper litigation. *Compare Old Time Enter., Inc. v. International Coffee Corp.*, 862 F.2d 1213, 1217 (5th Cir. 1989) (order proper) *with Marriott Bros. v. Gage*, 911 F.2d 1105, 1108, 1109-11 (5th Cir. 1990) (plaintiffs bound by answer to order; copy of order set out). Rule 56, too, is now extensively used to curtail implausible claims. *Compare Matsushita*, 475 U.S. at 587 *with California Architectural Bldg. Prods. Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1471 (9th Cir. 1987), *cert. denied*, 484 U.S. 1006 (1988). "[U]pon review . . . RICO abuse is not a serious problem for our legal system so long as counsel and courts appreciate the utility of existing remedial procedures. Accordingly, both Congress and the courts should recognize that abuse arguments are more likely motivated by hostility to the RICO remedy." Goldsmith and Keith, *Civil RICO Abuse: The Allegations in Context*, 1986 B.Y.U. L. Rev. 55, 103-04 (1986).

[234] *See also Haroco*, 747 F.2d at 399 n.16 (Cudahy, J.):

> [It is also true that] [t]he delays, expense and uncertainties of litigation often compel plaintiffs to settle completely valid claims for a mere fraction of their value. By adding to the settlement value of such valid claims in certain cases clearly involving criminal conduct, RICO may arguably promote more complete satisfaction of plaintiffs' claims without facilitating indefensible windfalls.

Similarly, studies under the antitrust statutes show that most treble damage suits are now settled at close to actual damages. Staff Of The House Comm. On The Judiciary, 98th Cong., 2d Sess., *Study Of The Antitrust Treble Damage Remedy*, Serial No. 8, House Comm. On The Judiciary, 98th Cong., 2d Sess. 14 (1984). A similar pattern is developing under RICO. *See Myths* at 919 n.189 (detailed analysis of the considerations of economics and justice in bringing and settling complex RICO litigation).

[235] *Institute's Brief* at 23.

[236] *Myths* at 921 n.190 (detailed analysis of RICO and federalism). Indeed, it is hard to see how RICO is inconsistent with federalism if it is supported by the National Conference of State Legislatures, the National Association of Insurance Commissioners, and the National Association of Attorneys General. *Id.* at 857 n.14.

environmental legislation. RICO, which also rests on the Commerce Clause, fits into this twentieth century legislation.[237]

The business community fought the antitrust statutes in 1890 and 1914.[238] The securities industry and the accounting profession fought the securities statutes in the 1930's.[239] Congress enacted the securities acts because state law was inadequate to deal with "racketeering" on Wall Street.[240] Critics then, as now, falsely suggest that such legislation threatens the viability of the market and learned professions.[241] Santayana suggested that those "who cannot remember the past are condemned to repeat it."[242] The truth may be

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[237] RICO and the antitrust statutes, for example, are well-integrated. "There are three possible kinds of force which a firm can resort to: violence (or the threat of it), deception, or market power." C. Kaysen & D. Turner, *Antitrust Policy* 17 (1959). RICO focuses on the first two; antitrust focuses on the third. As the antitrust laws seek to maintain economic freedom in the market place, so, too, RICO seeks to promote integrity in the market place, physical or fiscal.

[238] *See Equitable Relief* at 562 n.181 (Sherman Act), n.182 (Clayton Act).

[239] *See generally, id.* at 562 n.183 (securities acts); J. Seligman, *The Transformation of Wall Street* 79 (1983); Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 30 (1959). The Securities Act of 1933 encountered both open and undercover resistance from brokers and investment bankers. The president of the New York Stock Exchange led the fight against securities regulation by the federal government. J. Seligman, *supra*, at 90. In addition, Price Waterhouse & Co. was "opposed to . . . requirements for independent accountants." Landis, *supra*, at 35 n.12. The Investment Bankers Association issued a statement decrying the Act and asserting that its "practical results . . . [would] be to suspend the underwriting or distribution of many capital issues. . . . " *Id.* at 40 n.18. The 1933 Act then, like RICO today, was subject to "misinterpretation, deliberate to a great degree, by the widely publicized utterances of persons prominent in the financial world together with their lawyers." *Id.*

[240] *See, e.g.*, 77 Cong. Rec. 3801 (1933) (stat. of Sen. Duncan Fletcher, leading sponsor of the Securities Act of 1933) (the Securities Act is "designed to protect the public from financial racketeering of . . . 'investment bankers' . . . ").

[241] *Institute's Brief* at 21-22.

[242] G. Santayana, *The Life Of Reason* 284 (2d ed. 1922).

what history teaches is "that people and governments never learn anything from history."[243]

Multiple damage suits do not frustrate justice; they make it possible.[244] Indeed, studies show that private enforcement is the key to the antitrust statutes[245] and that treble damages are the backbone of private enforcement.[246] Fraud litigation, too, requires treble damages.[247]

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[243] G. Hegel, *The Philosophy Of History* 6 (J. Sibree trans. rev. ed. 1900).

[244] *See Equitable Relief* at 537 n.17 (history of idea of treble damages, adoption in other federal statutes, and economic analysis of wisdom, particularly in fraud area); Note, *Treble Damages Under RICO: Characterization and Computation*, 61 Notre Dame L. Rev. 526, 533-34 (1986):

> Treble damages have unique characteristics that can be creatively used to address the problems of sophisticated crime. Treble damages can be used to (1) encourage private citizens to bring RICO actions, (2) deter future violators, and (3) compensate victims for all accumulative harm. These multiple and convergent purposes make the treble damage provision a powerful mechanism in the effort to vindicate the interests of those victimized by crime.

[245] Between 1960 and 1980, of the 22,585 civil and criminal cases brought under the antitrust provisions by the government or private parties, 84% were instituted by private plaintiffs. U.S. Dept of Justice, *Source Book of Criminal Justice Statistics* 431 (1981).

[246] *See, e.g.*, Block, Nold and Sidak, *The Deterrent Effect of Antitrust Enforcement*, 89 J. Pol. Econ. 429, 440 (1981) ("Neither imprisonment nor monetary penalties pose . . . a credible threat to colluding firms. . . . [T]he deterrent effect . . . [comes] from . . . the likelihood of an award of private treble damages. . . . ").

[247] *See Mosler v. S/P Enters., Inc.*, 888 F.2d 1138, 1143-44 (7th Cir. 1989) (RICO fraud) (Easterbrook, J.):

> Because [such] frauds are concealable, trebling is important to produce proper incentives. (Citations omitted.) If perpetrators pay what they took when they get caught, and keep the proceeds the rest of the time, then fraud is profitable. If victims recoup only what they lost, and face the burdens and uncertainties of the legal process plus the costs of their own counsel, then victory will not make them whole, and the shortfall may mean that victims will not vigorously investigate and litigate. Trebling [under RICO] addresses both halves of this equation.

Finally, the Attorney General[248] estimated in 1985 the cost of white-collar crime at $200 billion. Fraud, in short, is not a "garden variety"[249] problem,[250] but however it is labeled, it cries out to be "weeded".[251] The 1985 estimate, too, came before the revelations in the securities, thrift, and banking industries, among pension funds, and in the insurance field.[252] SIPC's role in the securities industry is paralleled by

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[248] 1985 *Att'y Gen. Ann. Rep.* 42.

[249] *Institute's Brief* at 23.

[250] Commissioner Philip A. Feigin aptly observed:

> Euphemisms like . . . "garden variety frauds" . . . are sanitized phrases . . . used by "legitimate businesses and individuals" to distinguish their frauds from the "real" frauds perpetrated by the "real" crooks.

1985 Hearings at 535 (Testimony of Philip A. Feigin, Assistant Securities Commissioner, Colorado Division of Securities, and Chair, Special Projects Committee, Enforcement Section, North American Securities Administrators Association, Inc.).

[251] *See Furman v. Cirrito*, 741 F.2d 524, 528-29 (2d Cir. 1984), *vacated on other grounds*, 473 U.S. 922 (1985):

> Despite the clarity of congress' language [in drafting RICO] defendants argue that since RICO's primary purpose is to eradicate organized crime, it is [not] directed . . . against businessmen engaged in 'garden variety fraud'. . . . While RICO's primary focus may have been on organized crime, when considering the statute congress also recognized that fraud is a pervasive problem throughout our society . . . which causes billions of dollars in loss each year. . . . congress further acknowledged that existing state and federal law was not capable of dealing with this problem.
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> * * *
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> When congress provided severe sanctions, both civil and criminal, for conducting the affairs of an 'enterprise' through a 'pattern of racketeering activity,' it provided no exception for businessmen, for white collar workers, for bankers, or for stockbrokers. If the conduct of such people can sometimes fairly be characterized as 'garden variety fraud,' we can only conclude that by the RICO statute congress has provided an additional means to weed that 'garden' of its fraud.

[252] The type of argument advanced by the amici for the adoption of a purchaser-seller limitation from silence in the legislative history was aptly described by this Court as a "dog-that-did-not-bark" theory. *Harrison*, 446 U.S. at

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government programs in the thrift and banking industry,[253]

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592. The accounting profession itself, however, is a "dog that did not bark" in the current thrift debacle. *Lincoln Savings & Loan Ass'n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990) ("what is difficult to understand is that with all the professional talent involved (both accounting and legal), why at least one professional would not have blown the whistle to stop the overreaching that took place in this case"); *Myths* at 903-05 (reviewing the general literature on the role of false financial reporting in the thrift and other financial scandals.). The accounting profession, in short, suggests that it fears unjustifiable suits. *Institute's Brief* at 18-21. The facts of the current financial scandals support it fearing justifiable efforts to hold it accountable.

The profession also seeks to support its position with reference to the powerful rhetoric of Justice Cardozo in *Ultramares Corp. v. Touche*, 255 N.Y. 170, 189, 174 N.E. 441, 444 (1931) ("liability in an indeterminate amount for an indeterminate time to an indeterminable class"). Several comments are in order.

First, the privity rule of *Ultramares* circumscribed malpractice (contract), not fraud (tort) liability, 255 N.Y. at 189, 174 N.E. at 448; RICO, on the other hand, deals with fraud (intent to defraud), not negligence (should have known).

Second, the privity rule is not unanimous. *See, e.g., H. Rosenblum, Inc. v. Adler*, 93 N.J. 324, 350, 461 A.2d 138, 152 (1983) (privity rule no longer followed) ("may cause accounting firms to engage in more thorough reviews . . . setting up stricter standards and applying closer supervision, which should . . . reduce the . . . instances in which liability would ensue"); Note, *Who Should Pay When Federally Insured Pension Funds Go Broke? A Strategy For Recovering From Wrongdoers*, 65 Notre Dame L. Rev. 308, 331 n.141 (1990) (case law development traced).

Third, unlike private litigants, SIPC vindicates public interests. *See supra* n. 17. The policy concerns that led this Court to adopt a purchaser-seller limitation in *Blue Chip* do not apply. Under SIPA, SIPC only pays customer claims when they are verified. *See* discussion *supra* nn. 23-25. In litigation by SIPC, the liability is concrete, fixed in amount, definite as to time, and does not depend on "plaintiff's capacity to manufacture claims of hypothetical action, unrestrained by independent evidence." *Virginia Bankshares*, 59 U.S.L.W. at 4889.

Sadly, *Blue Chip* stands as an unwarranted obstacle to SIPC's ability to preserve and restore its congressionally-mandated trust fund. *See Vigman*, 803 F.2d at 1519 ("Until the Supreme Court repudiates it, we are unable to do so"). As a Congressionally-created corporation, SIPC should be allowed, under Rule 10b-5, to bring wrongdoers to account for the collapse of broker-dealers, the loss of customer property, and the drain on the SIPC Fund, without regard to *Blue Chip*.

[253] Both the RTC and FDIC use RICO in carefully selected bank fraud litigation. *See, e.g., FSLIC v. Shearson-American Express, Inc.*, 658 F. Supp. 1331 (D.P.R. 1987); *FDIC v. Hardin*, 608 F. Supp. 348 (E.D. Tenn. 1985).

the pension field,[254] and the insurance industry.[255] The key element in each of these areas is trust,[256] which is ultimately a question of integrity. If anything, therefore, policy considerations argue for strengthening, not weakening, those laws that effectively underwrite integrity.

CONCLUSION

The judgment of the Ninth Circuit should be affirmed.

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254 *See, e.g., Thornton v. Evans*, 692 F.2d 1064, 1065 (7th Cir. 1982) (pension plan fraud) ("Evidence . . . traces a pattern which seems distressingly prevalent today: the savings of working men and women are pilfered, embezzled, parlayed, mismanaged and outright stolen by unscrupulous persons occupying positions of trust and confidence."). RICO is being used successfully on behalf of plan beneficiaries. *See, e.g., Crawford v. LaBoucherie Bernard Ltd.*, No. 83-0780 (D.D.C. Aug. 15, 1984), *aff'd*, 815 F.2d 117 (D.C. Cir.), *cert. denied*, 484 U.S. 943 (1987).

255 State insurance commissioners are using RICO to vindicate the interests of the companies that have been defrauded. *See, e.g., Schacht*, 711 F.2d at 1356-58; *North Carolina ex rel. Long v. Alexander & Alexander Servs., Inc.*, 680 F. Supp. 746, 749-51 (E.D.N.C. 1988).

256 On the sad state of "trust" in the business community today, *see Myths* at 917 n.175.

APPENDIX OF STATUTES AND REGULATIONS

RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT
(18 U.S.C. §§ 1961-68)

§ 1961. Definitions

As used in this chapter –

(1) "racketeering activity" means (A) any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under any of the following provisions of title 18, United States Code: Section 201 (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), sections 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1029 (relating to fraud and related activity in connection with access devices), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1344 (relating to financial institution fraud), sections 1461-1465 (relating to obscene matter), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1512 (relating to tampering with a witness, victim, or an informant), section 1513 (relating to retaliating against a witness, victim, or an informant), section 1951 (relating to interference with

commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), section 1956 (relating to the laundering of monetary instruments), section 1957 (relating to engaging in monetary transactions in property derived from specified unlawful activity), section 1958 (relating to use of interstate commerce facilities in the commission of murder-for-hire), sections 2251-2252 (relating to sexual exploitation of children), sections 2312 and 2313 (relating to interstate transportation of stolen motor vehicles), sections 2314 and 2315 (relating to interstate transportation of stolen property), and section 2321 (relating to trafficking in certain motor vehicles or motor vehicle parts), sections 2341-2346 (relating to trafficking in contraband cigarettes), sections 2421-24 (relating to white slave traffic), (C) any act which is indictable under title 29, United States Code, section 186 (dealing with restrictions on payments and loans to labor organizations) or section 501(c) (relating to embezzlement from union funds), (D) any offense involving fraud connected with a case under title 11, fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous drugs, punishable under any law of the United States, or (E) any act which is indictable under the Currency and Foreign Transactions Reporting Act;

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political

subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a State or political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States, a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter;

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether

any person has been involved in any violation of this chapter or of any final order, judgment, or decree of any court of the United States, duly entered in any case or proceeding arising under this chapter;

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, the Associate Attorney General of the United States any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter. Any department or agency so designated may use in investigations authorized by this chapter either the investigative provisions of this chapter or the investigative power of such department or agency otherwise conferred by law.

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§ 1962. Prohibited Activities.

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the

activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

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§ 1963. Criminal Penalties

(a) Whoever violates any provision of section 1962 of this chapter shall be fined under this title or imprisoned not more than 20 years (or for life if the violation is based on a racketeering activity for which the maximum penalty includes life imprisonment), or both, and shall forfeit to the United States, irrespective of any provisions of State law–

(1) any interest the person has acquired or maintained in violation of section 1962;

(2) any–

(A) interest in;

(B) security of;

(C) claim against; or

(D) property or contractual right of any kind affording a source of influence over;

any enterprise which the person has established, operated, controlled, conducted, or participated in the conduct of in violation of section 1962; and

(3) any property constituting, or derived from, any proceeds which the person obtained, directly or indirectly, from racketeering activity or unlawful debt collection in violation of section 1962.

The court, in imposing sentence on such person shall order, in addition to any other sentence imposed pursuant to this section, that the person forfeit to the United States all property described in this subsection. In lieu of a fine otherwise authorized by this section, a defendant who derives profits or other proceeds from

an offense may be fined not more than twice the gross profits or other proceeds.

(b) Property subject to criminal forfeiture under this section includes –

(1) real property, including things growing on, affixed to, and found in land; and

(2) tangible and intangible personal property, including rights, privileges, interests, claims and securities.

(c) All right, title, and interest in property described in subsection (a) vests in the United States upon the commission of the act giving rise to forfeiture under this section. Any such property that is subsequently transferred to a person other than the defendant may be the subject of a special verdict of forfeiture and thereafter shall be ordered forfeited to the United States, unless the transferee establishes in a hearing pursuant to subsection (*l*) that he is a bona fide purchaser for value of such property who at the time of purchase was reasonably without cause to believe that the property was subject to forfeiture under this section.

(d)(1) Upon application of the United States, the court may enter a restraining order or injunction, require the execution of a satisfactory performance bond, or take any other action to preserve the availability of property described in subsection (a) for forfeiture under this section –

(A) upon the filing of an indictment or information charging a violation of section 1962 of this chapter and alleging that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section; or

(B) prior to the filing of such an indictment or information, if, after notice to persons appearing to have an interest in the property and opportunity for a hearing, the court determines that –

(i) there is a substantial probability that the United States will prevail on the issue of forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the court, or otherwise made unavailable for forfeiture; and

(ii) the need to preserve the availability of the property through the entry of the requested order outweighs the hardship on any party against whom the order is to be entered:

Provided, however, That an order entered pursuant to subparagraph (B) shall be effective for not more than ninety days, unless extended by the court for good cause shown or unless an indictment or information described in subparagraph (A) has been filed.

(2) A temporary restraining order under this subsection may be entered upon application of the United States without notice or opportunity for a hearing when an information or indictment has not yet been filed with respect to the property, if the United States demonstrates that there is probable cause to believe that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section and that provision of notice will jeopardize the availability of the property for forfeiture. Such a temporary order expire not more than ten days after the date on which it is entered, unless extended for good cause shown or unless the party

against whom it is entered consents to an extension for a longer period. A hearing requested concerning an order entered under this paragraph shall be held at the earliest possible time, and prior to the expiration of the temporary order.

(3) The court may receive and consider, at a hearing held pursuant to this subsection, evidence and information that would be inadmissible under the Federal Rules of Evidence.

(e) Upon conviction of a person under this section, the court shall enter a judgment of forfeiture of the property to the United States and shall also authorize the Attorney General to seize all property ordered forfeited upon such terms and conditions as the court shall deem proper. Following the entry of an order declaring the property forfeited, the court may, upon application of the United States, enter such appropriate restraining orders or injunctions, require the execution of satisfactory performance bonds, appoint receivers, conservators, appraisers, accountants, or trustees, or take any other action to protect the interest of the United States in the property ordered forfeited. Any income accruing to, or derived from, an enterprise or an interest in an enterprise which has been ordered forfeited under this section may be used to offset ordinary and necessary expenses to the enterprise which are required by law, or which are necessary to protect the interest of the United States or third parties.

(f) Following the seizure of property ordered forfeited under this section, the Attorney General shall direct the disposition of the property by sale or any other commercially feasible means, making due provision for

the rights of any innocent persons. Any property right or interest not exercisable by, or transferable for value to, the United States shall expire and shall not revert to the defendant, nor shall the defendant or any person acting in concert with or on behalf of the defendant be eligible to purchase forfeited property at any sale held by the United States. Upon application of a person, other than the defendant or a person acting in concert with or on behalf of the defendant, the court may restrain or stay the sale or disposition of the property pending the conclusion of any appeal of the criminal case giving rise to the forfeiture, if the applicant demonstrates that proceeding with the sale or disposition of the property will result in irreparable injury, harm or loss to him. Notwithstanding 31 U.S.C. 3302(b), the proceeds of any sale or other disposition of property forfeited under this section and any moneys forfeited shall be used to pay all proper expenses for the forfeiture and the sale, including expenses of seizure, maintenance and custody of the property pending its deposition, advertising and court costs. The Attorney General shall deposit in the Treasury any amounts of such proceeds or moneys remaining after the payment of such expenses.

(g) With respect to property ordered forfeited under this section, the Attorney General is authorized to –

(1) grant petitions for mitigation or remission of forfeiture, restore forfeited property to victims of a violation of this chapter, or take any other action to protect the rights of innocent persons which is in the interest of justice and which is not inconsistent with the provisions of this chapter;

(2) compromise claims arising under this section;

(3) award compensation to persons providing information resulting in a forfeiture under this section;

(4) direct the disposition by the United States of all property ordered forfeited under this section by public sale or any other commercially feasible means, making due provision for the rights of innocent persons; and

(5) take appropriate measures necessary to safeguard and maintain property ordered forfeited under this section pending its disposition.

(h) The Attorney General may promulgate regulations with respect to –

(1) making reasonable efforts to provide notice to persons who may have an interest in property ordered forfeited under this section;

(2) granting petitions for remission or mitigation of forfeiture;

(3) the restitution of property to victims of an offense petitioning for remission or mitigation of forfeiture under this chapter;

(4) the disposition by the United States of forfeited property by public sale or other commercially feasible means;

(5) the maintenance and safekeeping of any property forfeited under this section pending its disposition; and

(6) the compromise of claims arising under this chapter.

Pending the promulgation of such regulations, all provisions of law relating to the disposition of property, or the

proceeds from the sale thereof, or the remission or mitigation of forfeitures for violation of the customs laws, and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to forfeitures incurred, or alleged to have been incurred, under the provisions of this section, insofar as applicable and not inconsistent with the provisions hereof. Such duties as are imposed upon the Customs Service or any persons with respect to the disposition of property under the customs law shall be performed under this chapter by the Attorney General.

(i) Except as provided in subsection (l), no party claiming an interest in property subject to forfeiture under this section may –

(1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section; or

(2) commence an action at law or equity against the United States concerning the validity of his alleged interest in the property subsequent to the filing of an indictment or information alleging that the property is subject to forfeiture under this section.

(j) The district courts of the United States shall have jurisdiction to enter orders as provided in this section without regard to the location of any property which may be subject to forfeiture under this section or which has been ordered forfeited under this section.

(k) In order to facilitate the identification or location of property declared forfeited and to facilitate the disposition of petitions for remission or mitigation of forfeiture, after the entry of an order declaring property

forfeited to the United States the court may, upon application of the United States, order that the testimony of any witness relating to the property forfeited be taken by deposition and that any designated book, paper, document, record, recording, or other material not privileged be produced at the same time and place, in the same manner as provided for the taking of depositions under Rule 15 of the Federal Rules of Criminal Procedure.

(l)(1) Following the entry of an order of forfeiture under this section, the United States shall publish notice of the order and of its intent to dispose of the property in such manner as the Attorney General may direct. The Government may also, to the extent practicable, provide direct written notice to any person known to have alleged an interest in the property that is the subject of the order of forfeiture as a substitute for published notice as to those persons so notified.

(2) Any person, other than the defendant, asserting a legal interest in property which has been ordered forfeited to the United States pursuant to this section may, within thirty days of the final publication of notice or his receipt of notice under paragraph (1), whichever is earlier, petition the court for a hearing to adjudicate the validity of his alleged interest in the property. The hearing shall be held before the court alone, without a jury.

(3) The petition shall be signed by the petitioner under penalty of perjury and shall set forth the nature and extent of the petitioner's right, title, or interest in the property, the time and circumstances of the petitioner's acquisition of the right, title, or interest in the property, any additional facts supporting the petitioner's claim, and the relief sought.

(4) The hearing on the petition shall, to the extent practicable and consistent with the interests of justice, be held within thirty days of the filing of the petition. The court may consolidate the hearing on the petition with a hearing on any other petition filed by a person other than the defendant under this subsection.

(5) At the hearing, the petitioner may testify and present evidence and witnesses on his own behalf, and cross-examine witnesses who appear at the hearing. The United States may present evidence and witnesses in rebuttal and in defense of its claim to the property and cross-examine witnesses who appear at the hearing. In addition to testimony and evidence presented at the hearing, the court shall consider the relevant portions of the record of the criminal case which resulted in the order of forfeiture.

(6) If, after the hearing, the court determines that the petitioner has established by a preponderance of the evidence that –

(A) the petitioner has a legal right, title, or interest in the property, and such right, title, or interest renders the order of forfeitures invalid in whole or in part because the right, title, or interest was vested in the petitioner rather than the defendant or was superior to any right, title, or interest of the defendant at the time of the commission of the acts which gave rise to the forfeiture of the property under this section; or

(B) the petitioner is a bona fide purchaser for value of the right, title, or interest in the property and was at the time of purchase reasonably without cause to believe that the property was subject to forfeiture under this section;

the court shall amend the order of forfeiture in accordance with its determination.

(7) Following the court's disposition of all petitions filed under this subsection, or if no such petitions are filed following the expiration of the period provided in paragraph (2) for the filing of such petitions, the United States shall have clear title to property that is the subject of the order of forfeiture and may warrant good title to any subsequent purchaser or transferee.

(m) ~~If any~~ of the property described in subsection (a), as a result of any act or omission of the defendant –

(1) cannot be located upon the exercise of due diligence;

(2) has been transferred or sold to, or deposited with, a third party;

(3) has been placed beyond the jurisdiction of the court;

(4) has been substantially diminished in value; or

(5) has been commingled with other property which cannot be divided without difficulty;

the court shall order the forfeiture of any other property of the defendant up to the value of any property described in paragraphs (1) through (5).

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§ 1964. Civil remedies

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter shall estop the defendant from denying the essential allegations of the

criminal offense in any subsequent civil proceeding brought by the United States.

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§ 1965. Venue and process

(a) Any civil action or proceeding under this chapter against any person may be instituted in the district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

(b) In any action under section 1964 of this chapter in any district court of the United States in which it is shown that the ends of justice require that other parties residing in any other district be brought before the court, the court may cause such parties to be summoned, and process for that purpose may be served in any judicial district of the United States by the marshal thereof.

(c) In any civil or criminal action or proceeding instituted by the United States under this chapter in the district court of the United States for any judicial district, subpenas issued by such court to compel the attendance of witnesses may be served in any other judicial district, except that in any civil action or proceeding no such subpena shall be issued for service upon any individual who resides in another district at a place more than one hundred miles from the place at which such court is held without approval given by a judge of such court upon a showing of good cause.

(d) All other process in any action or proceeding under this chapter may be served on any person in any judicial district in which such person resides, is found, has an agent, or transacts his affairs.

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§ 1966. Expedition of actions

In any civil action instituted under this chapter by the United States in any district court of the United States, the Attorney General may file with the clerk of such court a certificate stating that in his opinion the case is of general public importance. A copy of that certificate shall be furnished immediately by such clerk to the chief judge or in his absence to the presiding district judge of the district in which such action is pending. Upon receipt of such copy, such judge shall designate immediately a judge of that district to hear and determine action.

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§ 1967. Evidence

In any proceeding ancillary to or in any civil action instituted by the United States under this chapter the proceedings may be open or closed to the public at the discretion of the court after consideration of the rights of affected persons.

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§ 1968. Civil investigative demand

(a) Whenever the Attorney General has reason to believe that any person or enterprise may be in possession, custody, or control of any documentary materials relevant to a racketeering investigation, he may, prior to the institution of a civil or criminal proceeding thereon, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to produce such material for examination.

(b) Each such demand shall –

(1) state the nature of the conduct constituting the alleged racketeering violation which is under investigation and the provision of law applicable thereto;

(2) describe the class or classes of documentary material produced thereunder with such definiteness and certainty as to permit such material to be fairly identified;

(3) state that the demand is returnable forthwith or prescribe a return date which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying or reproduction; and

(4) identify the custodian to whom such material shall be made available.

(c) No such demand shall –

(1) contain any requirement which would be held to be unreasonable if contained in a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation; or

(2) require the production of any documentary evidence which would be privileged from disclosure if demanded by a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation.

(d) Service of any such demand or any petition filed under this section may be made upon a person by –

(1) delivering a duly executed copy thereof to any partner, executive officer, managing agent, or general agent thereof, or to any agent thereof authorized by appointment or by law to receive service of process on behalf of such person, or upon any individual person;

(2) delivering a duly executed copy thereof to the principal office or place of business of the person to be served; or

(3) depositing such copy in the United States mail, by registered or certified mail duly addressed to such person at its principal office or place of business.

(e) A verified return by the individual serving any such demand or petition setting forth the manner of such service shall be prima facie proof of such service. In the case of service by registered or certified mail, such return shall be accompanied by the return post office receipt of delivery of such demand.

(f) (1) The Attorney General shall designate a racketeering investigator to serve as racketeer document custodian, and such additional racketeering investigators as he shall determine from time to time to be necessary to serve as deputies to such officer.

(2) Any person upon whom any demand issued under this section has been duly served

shall make such material available for inspection and copying or reproduction to the custodian designated therein at the principal place of business of such person, or at such other place as such custodian and such person thereafter may agree and prescribe in writing or as the court may direct, pursuant to this section on the return date specified in such demand, or on such later date as such custodian may prescribe in writing. Such person may upon written agreement between such person and the custodian substitute for copies of all or any part of such material originals thereof.

(3) The custodian to whom any documentary material is so delivered shall take physical possession thereof, and shall be responsible for the use made thereof and for the return thereof pursuant to this chapter. The custodian may cause the preparation of such copies of such documentary material as may be required for official use under regulations which shall be promulgated by the Attorney General. While in the possession of the custodian, no material so produced shall be available for examination, without the consent of the person who produced such material, by any individual other than the Attorney General. Under such reasonable terms and conditions as the Attorney General shall prescribe, documentary material while in the possession of the custodian shall be available for examination by the person who produced such material or any duly authorized representatives of such person.

(4) Whenever any attorney has been designated to appear on behalf of the United States before any court or grand jury in any case or proceeding involving any alleged violation of this chapter, the custodian may deliver to such

attorney such documentary material in the possession of the custodian as such attorney determines to be required for use in the presentation of such case or proceeding on behalf of the United States. Upon the conclusion of any such case or proceeding, such attorney shall return to the custodian any documentary material so withdrawn which has not passed into the control of such court or grand jury through the introduction thereof into the record of such case or proceeding.

(5) Upon the completion of –

(i) the racketeering investigation for which any documentary material was produced under this chapter, and

(ii) any case or proceeding arising from such investigation, the custodian shall return to the person who produced such material all such material other than copies thereof made by the Attorney General pursuant to this subsection which has not passed into the control of any court or grand jury through the introduction thereof into the record of such case or proceeding.

(6) When any documentary material has been produced by any person under this section for use in any racketeering investigation, and no such case or proceeding arising therefrom has been instituted within a reasonable time after completion of the examination and analysis of all evidence assembled in the course of such investigation, such person shall be entitled, upon written demand made upon the Attorney General, to the return of all documentary material other than copies thereof made pursuant to this subsection so produced by such person.

(7) In the event of the death, disability, or separation from service of the custodian of any

documentary material produced under any demand issued under this section or the official relief of such custodian from responsibility for the custody and control of such material, the Attorney General shall promptly –

(i) designate another racketeering investigator to serve as custodian thereof, and

(ii) transmit notice in writing to the person who produced such material as to the identity and address of the successor so designated.

Any successor so designated shall have with regard to such materials all duties and responsibilities imposed by this section upon his predecessor in office with regard thereto, except that he shall not be held responsible for any default or dereliction which occurred before his designation as custodian.

(g) Whenever any person fails to comply with any civil investigative demand duly served upon him under this section or whenever satisfactory copying or reproduction of any such material cannot be done and such person refuses to surrender such material, the Attorney General may file, in the district court of the United States for any judicial district in which such person resides, is found, or transacts business, and serve upon such person a petition for an order of such court for the enforcement of this section, except that if such person transacts business in more than one such district such petition shall be filed in the district in which such person maintains his principal place of business, or in such other district in which such person transacts business as may be agreed upon by the parties to such petition.

(h) Within twenty days after the service of any such demand upon any person, or at any time before the return date specified in the demand, whichever period is shorter, such person may file, in the district court of the United States for the judicial district within which such person resides, is found, or transacts business, and serve upon such custodian a petition for an order of such court modifying or setting aside such demand. The time allowed for compliance with the demand in whole or in part as deemed proper and ordered by the court shall not run during the pendency of such petition in the court. Such petition shall specify each ground upon which the petitioner relies in seeking such relief, and may be based upon any failure of such demand to comply with the provisions of this section or upon any constitutional or other legal right or privilege of such person.

(i) At any time during which any custodian is in custody or control of any documentary material delivered by any person in compliance with any such demand, such person may file, in the district court of the United States for the judicial district within which the office of such custodian is situated, and serve upon such custodian a petition for an order of such court requiring the performance by such custodian of any duty imposed upon him by this section.

(j) Whenever any petition is filed in any district court of the United States under this section, such court shall have jurisdiction to hear and determine the matter so presented, and to enter such order or orders as may be required to carry into effect the provisions of this section.

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§ 78aaa. Short title

This chapter may be cited as the "Securities Investor Protection Act of 1970".

SECURITIES INVESTOR PROTECTION ACT

(15 U.S.C. §§ 78aaa – 78111).

§ 78bbb. Application of Securities Act of 1934

Except as otherwise provided in this chapter, the provisions of the Securities Exchange Act of 1934 (hereinafter referred to as the "1934 Act") apply as if this chapter constituted an amendment to, and was included as a section of, such Act.

§ 78ccc. Securities Investor Protection Corporation

(a) Creation and membership. –

(1) Creation. – There is hereby established a body corporate to be known as the "Securities Investor Protection Corporation" (hereafter in this chapter referred to as "SIPC"). SIPC shall be a nonprofit corporation and shall have succession until dissolved by Act of Congress. SIPC shall –

(A) not be an agency or establishment of the United States Government; and

(B) except as otherwise provided in this chapter, be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act (D.C. Code, section 29-1001 and fol.).

(2) Membership. –

(A) Members of SIPC. – SIPC shall be a membership corporation the members of which shall be all persons registered as brokers or dealers under section 78o(b) of this title, other than –

(i) persons whose principal business, in the determination of SIPC, taking into account business of affiliated entities, is conducted outside the United States and its territories and possessions; and

(ii) persons whose business as a broker or dealer consists exclusively of (I) the distribution of shares of registered open and investment companies or unit investment trusts, (II) the sale of variable annuities, (III) the business of insurance, or (IV) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

(B) Commission review. – SIPC shall file with the Commission a copy of any determination made pursuant to subparagraph (A)(i). Within thirty days after the date of such filing, or within such longer period as the commission may designate of not more than ninety days after such date if it finds such longer period to be appropriate and publishes its reasons for so finding, the Commission shall, consistent with the public interest and the purposes of this chapter, affirm, reverse, or amend any such determination of SIPC.

(C) Additional members. – SIPC shall provide by rule that persons excluded from

membership in SIPC under subparagraph (A)(i) may become members of SIPC under such conditions and upon such terms as SIPC shall require by rule, taking into account such matters as the availability of assets and the ability to conduct a liquidation if necessary.

(D) Disclosure. – Any broker or dealer excluded from membership in SIPC under subparagraph (A)(i) shall, as required by the Commission by rule, make disclosures of its exclusion and other relevant information to the customers of such broker or dealer who are living in the United States or its territories and possessions.

(b) Powers. – In addition to the powers granted to SIPC elsewhere in this chapter, SIPC shall have the power

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any State, Federal, or other court;

(2) to adopt, alter, and use a corporate seal, which shall be judicially noticed;

(3) to adopt, amend, and repeal, by its Board of Directors, such bylaws as may be necessary or appropriate to carry out the purposes of this chapter, including bylaws relating to –

(A) the conduct of its business; and

(B) the indemnity of its directors, officers, and employees (including any such person acting as trustee or otherwise in connection with a liquidation proceeding) for liabilities and expenses actually and reasonably incurred by any such person in connection with the defense or settlement of an action or suit if such person acted in good

faith and in a manner reasonably believed to be consistent with the purposes of this chapter.

(4) to adopt, amend, and repeal, by its Board of Directors, such rules as may be necessary or appropriate to carry out the purposes of this chapter including rules relating to –

(A) the definition of terms used in this chapter, other than those terms for which a definition is provided in section 78*lll* of this title;

(B) the procedures for the liquidation of members and direct payment procedures, including the transfer of customer accounts, the distribution of customer property, and the advance and payment of SIPC funds; and

(C) the exercise of all other rights and powers granted to it by this chapter;

(5) to conduct its business (including the carrying on of operations and the maintenance of offices) and to exercise all other rights and powers granted to it by this chapter in any State or other jurisdiction without regard to any qualification, licensing, or other statute in such State or other jurisdiction;

(6) to lease, purchase, accept gifts or donations of or otherwise acquire, to own, hold, improve, use, or otherwise deal in or with, and to sell, convey, mortgage, pledge, lease exchange or otherwise dispose of, any property, real, personal or mixed, or any interest therein, wherever situated;

(7) subject to the provisions of subsection (c) of this section, to elect or appoint such officers, attorneys, employees, and agents as may be required, to determine their qualifications, to

define their duties, to fix their salaries, require bonds for them and fix the penalty thereof;

(8) to enter into contracts, to execute instruments, to incur liabilities, and to do any and all other acts and things as may be necessary or incidental to the conduct of its business and the exercise of all other rights and powers granted to SIPC by this chapter; and

(9) by bylaw, to establish its fiscal year.

(c) Board of Directors. –

(1) Functions. – SIPC shall have a Board of Directors which, subject to the provisions of this chapter, shall determine the policies which shall govern the operations of SIPC.

(2) Number and appointment. – The Board of Directors shall consist of seven persons as follows:

(A) One director shall be appointed by the Secretary of the Treasury from among the officers and employees of the Department of the Treasury.

(B) One director shall be appointed by the Federal Reserve Board from among the officers and employees of the Federal Reserve Board.

(C) Five directors shall be appointed by the President, by and with the advice and consent of the Senate, as follows –

(i) three such directors shall be selected from among persons who are associated with, and representative of different aspects of, the securities industry, not all of whom shall be from the geographical area of the United States, and

(ii) two such directors shall be selected from the general public from among persons who are not associated with a broker or dealer or associated with a member of a national securities exchange, within the meaning of section 78c(a)(18) or section 78c(a)(21), respectively, of this title, or similarly associated with any self-regulatory organization or other securities industry group, and who have not had any such association during the two years preceding appointment.

(3) Chairman and vice chairman. – The President shall designate a Chairman and Vice Chairman from among those directors appointed under paragraph (2)(C)(ii) of this subsection.

(4) Terms. –

(A) Except as provided in subparagraphs (B) and (C), each director shall be appointed for a term of three years.

(B) Of the directors first appointed under paragraph (2) –

(i) two shall hold office for a term expiring on December 31, 1971,

(ii) two shall hold office for a term expiring on December 31, 1972; and

(iii) three shall hold office for a term expiring on December 31, 1973,

as designated by the President at the time they take office. Such designation shall be made in a manner which will assure that no two persons appointed under the authority of the same clause of paragraph (2)(C) shall have terms which expire simultaneously.

(C) A vacancy in the Board shall be filled in the same manner as the original appointment was made. Any director appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the remainder of such term. A director may serve after the expiration of his term until his successor has taken office.

(5) Compensation. – All matters relating to compensation of directors shall be as provided in the bylaws of SIPC.

(d) Meetings of Board. – The Board of Directors shall meet at the call of its Chairman, or as otherwise provided by the bylaws of SIPC.

(e) Bylaws and rules. –

(1) Proposed bylaw changes. – The Board of Directors of SIPC shall file with the Commission a copy of any proposed bylaw or any proposed amendment to or appeal of any bylaw of SIPC (hereinafter in this paragraph collectively referred to as a "proposed bylaw change"), accompanied by a concise general statement of the basis and purpose of such proposed bylaw change. Each such proposed bylaw change shall take effect thirty days after the date of the filing of a copy thereof with the commission, or upon such later date as SIPC may designate or such earlier date as the Commission may determine, unless

(A) the Commission, by notice to SIPC setting forth the reasons therefor, disapproves such proposed bylaw change as being contrary to the public interest or contrary to the purposes of this chapter; or

(B) the Commission finds that such proposed bylaw change involves a matter of

such significant public interest that public comment should be obtained, in which case it may, after notifying SIPC in writing of such finding, require that the procedures set forth in paragraph (2) be followed with respect to such proposed bylaw change, in the same manner as if such proposed bylaw change were a proposed rule change within the meaning of such paragraph.

(2) Proposed rule changes. –

(A) Filing of proposed rule changes. – The Board of Directors of SIPC shall file with the Commission, in accordance with such rules as the Commission may prescribe, a copy of any proposed rule or any proposed amendment to or repeal of any rule of SIPC (hereinafter in this subsection collectively referred to as a "proposed rule change"), accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof, together with the terms of substance of such proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments with respect to such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this paragraph.

(B) Action by the Commission. – Within thirty-five days after the date of publication of notice of the filing of a proposed rule change, or within such longer period as the Commission may designate of not more than ninety days after such date if

it finds such longer period to be appropriate and publishes its reasons for so finding, or as to which SIPC consents, the Commission shall –

(i) by order approve such proposed rule change; or

(ii) institute proceedings to determine whether such proposed rule change should be disapproved.

(C) Proceedings. – Proceedings instituted with respect to a proposed rule change pursuant to subparagraph (B)(ii) shall include notice of the grounds for disapproval under consideration and opportunity for hearing, and shall be concluded within one hundred eighty days after the date of publication of notice of the filing of such proposed rule change. At the conclusion of such proceedings, the Commission shall, by order, approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for not more than sixty days if it finds good cause for such extension and publishes its reasons for so finding, or for such longer period as to which SIPC consents.

(D) Grounds for approval or disapproval. – The Commission shall approve a proposed rule change if it finds that such proposed rule change is in the public interest and is consistent with the purposes of this chapter, and any proposed rule change so approved shall be given force and effect as if promulgated by the Commission. The Commission shall disapprove a proposed rule change if it does not make the finding referred to in the preceding sentence. The commission shall not approve any proposed

rule change prior to thirty days after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(E) Exception. – Notwithstanding any other provision of this paragraph, a proposed rule change may take effect –

(i) upon the date of filing with the Commission, if such proposed rule change is designated by SIPC as relating solely to matters which the Commission, consistent with the public interest and the purposes of this subsection, determines by rule do not require the procedures set forth in this paragraph; or

(ii) upon such date as the Commission shall for good cause determine. Any proposed rule change which takes effect under this clause shall be filed promptly thereafter and reviewed in accordance with the provisions of subparagraph (A).

At any time within sixty days after the date of filing of any rule change which has taken effect pursuant to this subparagraph, the Commission may summarily abrogate such rule change and require that it be refiled and reviewed in accordance with the provisions of this paragraph, if the commission finds that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter. Any action of the Commission pursuant to the preceding sentence shall not affect the validity or force of a rule change during the period it was in effect and shall not be reviewable under section 78y of this title or deemed to be final

agency action for purposes of section 704 of Title 5.

(3) Action required by Commission. – The Commission may, by such rules as it determines to be necessary or appropriate in the public interest or to carry out the purposes of this chapter, require SIPC to adopt, amend, or repeal any SIPC bylaw or rule, whenever adopted.

§ 78ddd. SIPC Fund

(a) In general. –

(1) Establishment of fund. – SIPC shall establish a "SIPC Fund" (hereinafter in this chapter referred to as the "fund"). All amounts received by SIPC (other than amounts paid directly to any lender pursuant to any pledge securing a borrowing by SIPC) shall be deposited in the fund, and all expenditures made by SIPC shall be made out of the fund.

(2) Balance of the fund. – Except as otherwise provided in this section, the balance of the fund at any time shall consist of the aggregate at such time of the following items:

(A) Cash on hand or on deposit.

(B) Amounts invested in United States Government or agency securities.

(C) Such confirmed lines of credit as SIPC may from time to time maintain, other than those maintained pursuant to paragraph (4).

(3) Confirmed lines of credit. – For purposes of this section, the amount of confirmed lines of credit as of any time is the aggregate amount which SIPC at such time has the right to borrow from banks and other financial institutions under confirmed lines of credit or other

written agreements which provide that moneys so borrowed are to be repayable by SIPC not less than one year from the time of such borrowings (including, for purposes of determining when such moneys are repayable, all rights of extension, refunding, or renewal at the election of SIPC).

(4) Other lines. – SIPC maintain such other confirmed lines of credit as it considers necessary or appropriate, and such other confirmed lines of credit shall not be included in the balance of the fund, but amounts received from such lines of credit may be disbursed by SIPC under this chapter as though such amounts were part of the fund.

(b) Initial required balance for fund. – Within one hundred and twenty days from December 30, 1970, the balance of the fund shall aggregate not less than $75,000,000 less any amounts expended from the fund within that period.

(c) Assessments. –

(1) Initial assessments. – Each member of SIPC shall pay to SIPC, or the collection agent for SIPC specified in section 78iii(a) of this title, on or before the one hundred and twentieth day following December 30, 1970, an assessment equal to one-eighth of 1 per centum of the gross revenues from the securities business of such member during the calendar year 1969, or if the commission shall determine that, for purposes of assessment pursuant to this paragraph, a lesser percentage of gross revenues from the securities business is appropriate for any class or classes of members (taking into account relevant factors, including but not limited to types of business done and nature of securities sold), such lesser percentages as the Commission, by

rule or regulation, shall establish for such class or classes, but in no event less than one-sixteenth of 1 per centum for any such class. In no event shall any assessment upon a member pursuant to this paragraph be less than $150.

(2) General assessment authority. – SIPC shall, by bylaw, impose upon its members such assessments as, after consultation with self-regulatory organizations, SIPC may deem necessary and appropriate to establish and maintain the fund and to repay any borrowings by SIPC. Any assessments so made shall be in conformity with contractual obligations made by SIPC in connection with any borrowing incurred by SIPC. Subject to paragraph (3) and subsection (d)(1)(A) of this section, any such assessment upon the members, or any one or more classes thereof, may, in whole or in part, be based upon or measured by (A) the amount of their gross revenues from the securities business, or (B) all or any of the following factors: the amount or composition of their gross revenues from the securities business, the number or dollar volume of transactions effected by them, the number of customer accounts maintained by them or the amounts of cash and securities in such accounts, their net capital, the nature of their activities (whether in the securities business or otherwise) and the consequent risks, or other relevant factors.

(3) Limitations. – Notwithstanding any other provision of this chapter –

(A) no assessment shall be made upon a member otherwise than pursuant to paragraph (1) or (2) of this subsection,

(B) an assessment may be made under paragraph (2) of this subsection at a rate in excess of one-half of one per centum during

any twelve-month period if SIPC determines, in accordance with a bylaw, that such rate of assessment during such period will not have a material adverse effect on the financial condition of its members or their customers, except that no assessments shall be made pursuant to such paragraph upon a member which require payments during any such period which exceed in the aggregate one per centum of such member's gross revenues from the securities business for such period, and

(C) no assessment shall include any charge based upon the member's activities (i) in the distribution of shares of registered open end investment companies or unit investment trusts, (ii) in the sale of variable annuities, (iii) in the business of insurance, or (iv) in the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

(d) Requirements respecting assessments and lines of credit. –

(1) Assessments. –

(A) ½ of 1 percent assessment. – Subject to subsection (c)(3) of this section, SIPC shall impose upon each of its members an assessment at a rate of not less than one-half of 1 per centum per annum of the gross revenues from the securities business of such member –

(i) until the balance of the fund aggregates not less than $150,000,000 (or such other amount as the Commission may determine in the public interest),

(ii) during any period when there is outstanding borrowing by SIPC pursuant to subsection (f) or subsection (g) of this section, and

(iii) whenever the balance of the fund (exclusive of confirmed lines of credit) is below $100,000,000 (or such other amount as the Commission may determine in the public interest).

(B) 1/4 of 1 percent assessment. – During any period during which –

(i) the balance of the fund (exclusive of confirmed lines of credit) aggregates less than $150,000,000 (or such other amount as the Commission has determined under paragraph (2)(B)), or

(ii) SIPC is required under paragraph (2)(B) to phase out of the fund all confirmed lines of credit,

SIPC shall endeavor to make assessments in such a manner that the aggregate assessments payable by its members during such period shall not be less than one-fourth of 1 per centum per annum of the aggregate gross revenues from the securities business for such members during such period.

(C) Minimum assessment. – The minimum assessment imposed upon each member of SIPC shall be $25 per annum through the year ending December 31, 1979, and thereafter shall be the amount from time to time set by SIPC bylaw, but in no event shall the minimum assessment be greater than $150 per annum.

(2) Lines of credit. –

(A) $50,000,000 limit after 1973. – After December 31, 1973, confirmed lines of credit shall not constitute more than $50,000,000 of the balance of the fund.

(B) Phaseout requirement. – When the balance of the fund aggregates $150,000,000 (or such other amount as the Commission may determine in the public interest) SIPC shall phase out of the fund all confirmed lines of credit.

(e) Prior trusts; overpayments and underpayments. –

(1) Prior trusts. – There may be contributed and transferred at any time to SIPC any funds held by any trust established by a self-regulatory organization prior to January 1, 1970, and the amounts so contributed and transferred shall be applied, as may be determined by SIPC with approval of the Commission, as a reduction in the amounts payable pursuant to assessments made or to be made by SIPC upon members of such self-regulatory organization pursuant to subsection (c)(2) of this section. No such reduction shall be made at any time when there is outstanding any borrowing of SIPC pursuant to subsection (g) of this section or any borrowings under confirmed lines of credit.

(2) Overpayments. – To the extent that any payment by a member exceeds the maximum rate permitted by subsection (c) of this section, the excess shall be recoverable only against future payments by such member, except as otherwise provided by SIPC bylaw.

(3) Underpayments. – If a member fails to pay when due all or any part of an assessment made upon such member, the unpaid portion thereof shall bear interest at such rate as may be determined by SIPC bylaw and, in addition to such interest, SIPC may impose such penalty charge as may be determined by SIPC bylaw. Any such penalty charge imposed upon a SIPC member shall not exceed 25 per centum of any unpaid portion of the assessment. SIPC may

waive such penalty charge in whole or in part in circumstance where it considers such waiver appropriate.

(f) Borrowing authority. – SIPC shall have the power to borrow moneys and to evidence such borrowed moneys by the issuance of bonds, notes, or other evidences of indebtedness, all upon such terms and conditions as the Board of Directors may determine in the case of a borrowing other than pursuant to subsection (g) of this section, or as may be prescribed by the Commission in the case of a borrowing pursuant to subsection (g) of this section. The interest payable on a borrowing pursuant to subsection (g) of this section shall be equal to the interest payable on the related notes or other obligations issued by the Commission to the Secretary of the Treasury. To secure the payment of the principal of, and interest and premium, if any, on, all bonds, notes, or other evidences of indebtedness so issued, SIPC may make agreements with respect to the amount of future assessments to be made upon members and may pledge all or any part of the assets of SIPC and of the assessments made or to be made upon members. Any such pledge of future assessments shall (subject to any prior pledge) be valid and binding from the time that it is made, and the assessments so pledged and thereafter received by SIPC, or any collection agent for SIPC, shall immediately be subject to the lien of such pledge without any physical delivery thereof or further act, and the lien of such pledge shall be valid and binding against all parties having claims of any kind against SIPC or such collection agent whether pursuant to this chapter, in tort, contract or otherwise, irrespective of whether such parties have notice thereof. During any period when a borrowing by

SIPC pursuant to subsection (g) of this section is outstanding, no pledge of any assessment upon a member to secure any bonds, notes, or other evidences of indebtedness issued other than pursuant to subsection (g) of this section shall be effective as to the excess of the payments under the assessment on such member during any twelve-month period over one-fourth of 1 per centum of such member's gross revenues from the securities business for such period. Neither the instrument by which a pledge is authorized or created, nor any statement or other document relative thereto, need be filed or recorded in any State or other jurisdiction. The Commission may by rule or regulation provide for the filing of any instrument by which a pledge or borrowing is authorized or created, but the failure to make or any defect in any such filing shall not affect the validity of such pledge or borrowing.

(g) SEC Loans to SIPC. – In the event that the fund is or may reasonably appear to be insufficient for the purposes of this chapter, the commission is authorized to make loans to SIPC. At the time of application for, and as a condition to, any such loan, SIPC shall file with the Commission a statement with respect to the anticipated use of the proceeds of the loan. If the commission determines that such loan is necessary for the protection of customers of brokers or dealers and the maintenance of confidence in the United States securities markets and that SIPC has submitted a plan which provides as reasonable an assurance of prompt repayment as may be feasible under the circumstances, then the Commission shall so certify to the Secretary of the Treasury, and issue notes

or other obligations to the Secretary of the Treasury pursuant to subsection (h) of this section. If the Commission determines that the amount or time for payment of the assessments pursuant to such plan would not satisfactorily provide for the repayment of such loan, it may, by rules and regulations, imposed upon the purchasers of equity securities in transactions on national securities exchanges and in the over-the-counter markets a transaction fee in such amount as at any time or from time to time it may determine to be appropriate, but not exceeding one-fiftieth of 1 per centum of the purchase price of the securities. No such fee shall be imposed on a transaction (as defined by rules or regulations of the Commission) of less than $5,000. For the purposes of the next preceding sentence, (1) the fee shall be based upon the total dollar amount of each purchase; (2) the fee shall not apply to any purchase on a national securities exchange or in an over-the-counter market by or for the account of a broker or dealer registered under section 78o(b) of this title unless such purchase is for an investment account of such broker or dealer (and for this purpose any transfer from a trading account to an investment account shall be deemed a purchase at fair market value); and (3) the Commission may, by rule, exempt any transaction in the over-the-counter markets or on any national securities exchange where necessary to provide for the assessment of fees on purchasers in transactions in such markets and exchanges on a comparable basis. Such fee shall be collected by the broker or dealer effecting the transaction for or with the purchaser, or by such other person as provided by the Commission by rule, and shall be paid to

SIPC in the same manner as assessments imposed pursuant to subsection (c) of this section but without regard to the limits on such assessments, or in such other manner as the Commission may by rule provide.

(h) SEC Notes issued to Treasury. – To enable the Commission to make loans under subsection (g) of this section, the Commission is authorized to issue to the Secretary of the Treasury notes or other obligations in an aggregate amount of not to exceed $1,000,000,000, in such forms and denominations, bearing such maturities, and subject to such terms and conditions, as may be prescribed by the Secretary of the Treasury. Such notes or other obligations shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities during the month preceding the issuance of the notes or other obligations. The Secretary of the Treasury may reduce the interest rate if he determines such reduction to be in the national interest. The Secretary of the Treasury is authorized and directed to purchase any notes and other obligations issued hereunder and for that purpose he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under chapter 31 of Title 31, and the purposes for which securities may be issued under that chapter are extended to include any purchase of such notes and obligations. The Secretary of the Treasury may at any time sell any of the notes or other obligations acquired by him under this

subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such notes or other obligations shall be treated as public debt transactions of the United States.

(i) Consolidated group. – Except as otherwise provided by SIPC bylaw, gross revenues from the securities business of a member of SIPC, shall be computed on a consolidated basis for such member and all its subsidiaries (other than the foreign subsidiaries of such member), and the operations of a member of SIPC shall include those of any business to which such member has succeeded.

§ 78eee. Protection of customers

(a) Determination of need of protection.

(1) Notice to SIPC. – If the Commission or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, it shall immediately notify SIPC, and, if such notification is by a self-regulatory organization, the Commission.

(2) Action by self-regulatory organization. – If a self-regulatory organization has given notice to SIPC pursuant to subsection (a)(1) of this section with respect to a broker or dealer, and such broker or dealer undertakes to liquidate or reduce its business either pursuant to the direction of a self-regulatory organization or voluntarily, such self-regulatory organization may render such assistance or oversight to such broker or dealer as it considers appropriate to protect the interests of customers of such broker or dealer. The assistance or oversight by a self-regulatory organization shall not be deemed the assumption or adoption by such self-regulatory

organization of any obligation or liability to customers, other creditors, shareholders, or partners of the broker or dealer, and shall not prevent or act as a bar to any action by SIPC.

(3) Action by SIPC. – If SIPC determines that –

(A) any member of SIPC (including any person who was a member within one hundred eighty days prior to such determination) has failed or is in danger of failing to meet its obligations to customers; and

(B) one or more of the conditions specified in subsection (b)(1) of this section exist with respect to such member, SIPC may, upon notice to such member, file an application for a protective decree with any court of competent jurisdiction specified in section 78u(e) or 78aa of this title, except that no such application shall be filed with respect to a member the only customers of which are persons whose claims could not be satisfied by SIPC advances pursuant to section 78fff-3 of this title.

(4) Effect of other pending actions. – An application with respect to a member of SIPC filed with a court under paragraph (3) –

(A) may, with consent of the Commission, be combined with any action brought by the Commission, including an action by the Commission for a temporary receiver pending an appointment of a trustee under subsection (b)(3) of this section; and

(B) may be filed notwithstanding the pendency in the same or any other court of any bankruptcy, mortgage foreclosure, or equity receivership proceeding or any proceeding to reorganize, conserve, or liquidate

such member or its property, or any proceeding to enforce a lien against property of such member.

(b) Court action. –

(1) Issuance of protective decree. – Upon receipt of an application by SIPC under subsection (a)(3) of this section, the court shall forthwith issue a protective decree if the debtor consents thereto, if the debtor fails to contest such application, or if the court finds that such debtor –

(A) is insolvent within the meaning of section 101 of Title 11, or is unable to meet its obligations as they mature;

(B) is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed;

(C) is not in compliance with applicable requirements under the 1934 Act or rules of the Commission or any self-regulatory organization with respect to financial responsibility or hypothecation of customers' securities; or

(D) is unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules.

Unless the debtor consents to the issuance of a protective decree, the application shall be heard three business days after the date on which it is filed, or at such other time as the court shall determine, taking into consideration the urgency which the circumstances require.

(2) Jurisdiction and powers of court. –

(A) Exclusive jurisdiction. – Upon the filing of an application with a court for a protective decree with respect to a debtor, such court –

(i) shall have exclusive jurisdiction of such debtor and its property wherever located (including property located outside the territorial limits of such court and property held by any other person as security for a debt or subject to a lien);

(ii) shall have exclusive jurisdiction of any suit against the trustee with respect to a liquidation proceeding; and

(iii) except as inconsistent with the provisions of this chapter, shall have the jurisdiction, powers, and duties conferred upon a court of the United States having jurisdiction over cases under Title 11, together with such other jurisdiction, powers, and duties as are prescribed by this chapter.

(B) Stay of pending actions. – Pending the issuance of a protective decree under paragraph (1), the court with which an application has been filed –

(i) shall stay any pending bankruptcy, mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the debtor or its property and any other suit against any receiver, conservator, or trustee of the debtor or its property, and shall continue such stay upon appointment of a trustee pursuant to paragraph (3);

(ii) may stay any proceeding to enforce a lien against property of the debtor or any other suit against the debtor, including a suit by stockholders of the debtor which interferes with prosecution by the trustee of claims against former directors, officers, or employees of the debtor, and may continue such stay upon appointment of a trustee pursuant to paragraph (3);

(iii) may stay enforcement of, and upon appointment of a trustee pursuant to paragraph (3), may continue the stay for such period of time as may be appropriate, but shall not abrogate any right of setoff, except to the extent such right may be affected under section 553 of Title 11, and shall not abrogate the right to enforce a valid, nonpreferential lien or pledge against the property of the debtor; and

(iv) may appoint a temporary receiver.

(3) Appointment of trustee and attorney. – If the court issues a protective decree under paragraph (1), such court shall forthwith appoint, as trustee for the liquidation of the business of the debtor and as attorney for the trustee, such persons as SIPC, in its sole discretion, specifies. The persons appointed as trustee and as attorney for the trustee may be associated with the same firm. SIPC may, in its sole discretion, specify itself or one if its employees as trustee in any case in which SIPC has determined that the liabilities of the debtor to unsecured general creditors and to subordinated lenders appear to aggregate less than $750,000 and that there appear to be fewer than five hundred customers of such debtor. No person

may be appointed to serve as trustee or attorney for the trustee if such person is not disinterested within the meaning of paragraph (6), except that for any specified purpose other than to represent a trustee in conducting a liquidation proceeding, the trustee may, with the approval of SIPC and the court, employ an attorney who is not disinterested. A trustee appointed under this paragraph shall qualify by filing a bond in the manner prescribed by section 322 of Title 11, except that neither SIPC nor any employee of SIPC shall be required to file a bond when appointed as trustee.

(4) Removal to bankruptcy court. – Upon the issuance of a protective decree and appointment of a trustee, or a trustee and counsel, under this section, the court shall forthwith order the removal of the entire liquidation proceeding to the court of the United States in the same judicial district having jurisdiction over cases under Title 11. The latter court shall thereupon have all of the jurisdiction, powers, and duties conferred by this chapter upon the court to which application for the issuance of the protective decree was made.

(5) Compensation for services and reimbursement of expenses. –

(A) Allowances in general. – The court shall grant reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred (hereinafter in this paragraph referred to as "allowances") by a trustee, and by the attorney for such a trustee, in connection with a liquidation proceeding. No allowances (other than reimbursement for proper costs and expenses incurred) shall be granted to SIPC or any employee of SIPC for serving as trustee. Allowances may be granted on an

interim basis during the course of the liquidation proceeding at such times and in such amounts as the court considers appropriate.

(B) Application for allowances. – Any person seeking allowances shall file with the court an application which complies in form and content with the provisions of Title 11 governing applications for allowances under such title. A copy of such application shall be served upon SIPC when filed. The court shall fix a time for a hearing on such application, and notice of such hearing shall be given to the applicant, the trustee, the debtor, the creditors, SIPC, and such other persons as the court may designate, except that notice need not be given to customers whose claims have been or will be satisfied in full or to creditors who cannot reasonably be expected to receive any distribution during the course of the liquidation proceeding.

(C) Recommendations of SIPC and awarding of allowances. – Whenever an application for allowances is filed pursuant to subparagraph (B), SIPC shall file its recommendation with respect to such allowances with the court prior to the hearing on such application and shall, if it so requests, be allowed a reasonable time after such hearing within which to file a further recommendation. In any case in which such allowances are to be paid by SIPC without reasonable expectation of recoupment thereof as provided in this chapter and there is no difference between the amounts requested and the amounts recommended by SIPC, the court shall award the amounts recommended by SIPC. In determining the amount of allowances in all other cases, the

court shall give due consideration to the nature, extent, and value of the services rendered, and shall place considerable reliance on the recommendation of SIPC.

(D) Applicable restrictions. – The restrictions on sharing of compensation set forth in section 504 of Title 11 shall apply to allowances.

(E) Charge against estate. – Allowances granted by the court, including interim allowances, shall be charged against the general estate of the debtor as a cost and expense of administration. If the general estate is insufficient to pay allowances in whole or in part, SIPC shall advance such funds as are necessary for such payment.

(6) Disinterestedness. –

(A) Standards. – For purposes of paragraph (3), a person shall not be deemed disinterested if –

(i) such person is a creditor (including a customer), stockholder, or partner of the debtor;

(ii) such persons is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the filing date as the underwriter of any securities of the debtor;

(iii) such person is, or was within two years prior to the filing date, a director, partner, officer, or employee of the debtor or such an underwriter, or an attorney for the debtor or such an underwriter; or

(iv) it appears that such person has, by reason of any other direct or

indirect relationship to, connection with, or interest in the debtor or such an underwriter, or for any other reason, an interest materially adverse to the interests of any class of creditors (including customers) or stockholders.

except the SIPC shall in all cases be deemed disinterested, and an employee of SIPC shall be deemed disinterested if such employee would, except for his association with SIPC, meet the standards set forth in this subparagraph.

(B) Hearing. – The court shall fix a time for a hearing on disinterestedness, to be held promptly after the appointment of a trustee. Notice of such hearing shall be mailed at least ten days prior thereto to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor, and to the creditors and stockholders of the debtor, to SIPC, and to such other persons as the court may designate. The court may, in its discretion, also require that notice be given by publication in such newspaper or newspapers of general circulation as it may designate. At such hearing, at any adjournment thereof, or upon application, the court shall hear objections to the retention in office of a trustee or attorney for a trustee on the grounds that such person is not disinterested.

(c) SEC participation in proceedings. – The Commission may, on its own motion, file notice of its appearance in

any proceeding under this chapter and may thereafter participate as a party.

(d) SIPC participation. – SIPC shall be deemed to be a party in interest as to all matters arising in a liquidation proceeding, with the right to be heard on all such matters, and shall be deemed to have intervened with respect to all such matters with the same force and effect as if a petition for such purpose had been allowed by the court.

§ 78fff. General provisions of a liquidation proceeding

(a) Purposes. – The purposes of a liquidation proceeding under this chapter shall be –

(1) as promptly as possible after the appointment of a trustee in such liquidation proceeding, and in accordance with the provisions of this chapter –

(A) to deliver customer name securities to or on behalf of the customers of the debtor entitled thereto as provided in section 78fff-2(c)(2) of this title; and

(B) to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers to the extent provided in this section;

(2) to sell or transfer offices and other productive units of the business of the debtor;

(3) to enforce rights of subrogation as provided in this chapter; and

(4) to liquidate the business of the debtor.

(b) Application of Title 11. – To the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of Title 11. For the purposes of applying such title in carrying out this section, a reference in such title to the date of the filing of the petition shall be deemed to be a reference to the filing date under this chapter.

(c) Determination of customer status. – In a liquidation proceeding under this chapter, whenever a person has acted with respect to cash or securities with the debtor after the fling date and in a manner which would have given him the status of a customer with respect to such cash or securities had the action occurred prior to the filing date, and the trustee is satisfied that such action was taken by the customer in good faith and prior to the appointment of the trustee, the date on which such action was taken shall be deemed to be the filing date for purposes of determining the net equity of such customer with respect to such cash or securities.

(d) Apportionment. – Any liquidation proceeding under this chapter, any cash or securities remaining after the liquidation of a lien or pledge made by a debtor shall be apportioned between his general estate and customer property in the proportion in which the general property of the debtor and the cash and securities of the customers of such debtor contributed to such lien or pledge. Securities apportioned to the general estate under this subsection shall be subject to the provisions of section 78*lll*(5)(A) of this title.

(e) Costs and expenses of administration. – All costs and expenses of administration of the estate of the debtor and of the liquidation proceeding shall be borne by the general estate of the debtor to the extent it is sufficient therefor, and the priorities of distribution from the general estate shall be as provided in section 726 of Title 11. Costs and expenses of administration shall include payments pursuant to section 78fff-2(e) of this title and section 78fff-3(c)(1) of this title (to the extent such payments recovered securities which were apportioned to the general estate pursuant to subsection (d) of this section) and costs and expenses of SIPC employees utilized by the trustee pursuant to section 78fff-1(a)(2) of this title. All funds advanced by SIPC to a trustee for such costs and expenses of administration shall be recouped from the general estate under section 507(a)(1) of Title 11.

§ 78fff-1. Powers and duties of a trustee

(a) Trustee powers. – A trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under Title 11. In addition, a trustee may, with the approval of SIPC but without any need for court approval –

(1) hire and fix the compensation of all personnel (including officers and employees of the debtor and of its examining authority) and other persons (including accountants) that are deemed by the trustee necessary for all or any purposes of the liquidation proceeding;

(2) utilize SIPC employees for all or any purposes of a liquidation proceeding; and

(3) margin and maintain customer accounts of the debtor for the purposes of section 78fff-2(f) of this title.

(b) Trustee duties. – To the extent consistent with the provisions of this chapter or as otherwise ordered by the court, a trustee shall be subject to the same duties as a trustee in a case under chapter 7 of Title 11, including, if the debtor is a commodity broker, as defined under section 101 of such title, the duties specified in subchapter IV of such chapter 7, except that a trustee may, but shall have no duty to, reduce to money any securities constituting customer property or in the general estate of the debtor. In addition, the trustee shall –

(1) deliver securities to or on behalf of customers to the maximum extent practicable in satisfaction of customer claims for securities of the same class and series of an issuer; and

(2) subject to the prior approval of SIPC but without any need for court approval, pay or guarantee all or any part of the indebtedness of the debtor to a bank, lender, or other person if the trustee determines that the aggregate market value of securities to be made available to the trustee upon the payment or guarantee of such indebtedness does not appear to be less than the total amount of such payment or guarantee.

(c) Reports by trustee to court. – The trustee shall make to the court and to SIPC such written reports as may be required of a trustee in a case under chapter 7 of Title 11, and shall include in such reports information with respect to the progress made in distributing cash and securities to customers. Such reports shall be in such form and detail as the Commission determines by rule to present fairly the results of the liquidation proceeding as

of the date of or for the period covered by such reports, having due regard for the requirements of section 78q of this title and the rules prescribed under such section and the magnitude of items and transactions involved in connection with the operations of a broker or dealer.

(d) Investigations. – The trustee shall –

(1) as soon as practicable, investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business, and any other matter, to the extent relevant to the liquidation proceeding, and report thereon to the court;

(2) examine, by deposition or otherwise, the directors and officers of the debtor and any other witnesses concerning any of the matters referred to in paragraph (1);

(3) report to the court any facts ascertained by the trustee with respect to fraud, misconduct, mismanagement, and irregularities, and to any causes of action available to the estate; and

(4) as soon as practicable, prepare and submit, to SIPC and such other persons as the court designates and in such form and manner as the court directs, a statement of his investigation of matters referred to in paragraph (1).

§ 78fff-2. Special provisions of a liquidation proceeding

(a) Notice and claims. –

(1) Notice of proceedings. – Promptly after the appointment of the trustee, such trustee shall cause notice of the commencement of proceedings under this section to be published in one or more newspapers of general circulation

in the form and manner determined by the court, and at the same time shall cause a copy of such notice to be mailed to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor. Notice to creditors other than customers shall be given in the manner prescribed by Title 11, except that such notice shall be given by the trustee.

(2) Statement of claim. – A customer shall file with the trustee a written statement of claim but need not file a formal proof of claim, except that no obligation of the debtor to any person associated with the debtor within the meaning of section 78c(a)(18) of this title or section 78c(a)(21) of this title, any beneficial owner of 5 per centum or more of the voting stock of the debtor or any member of the immediate family of any such person or owner may be satisfied without formal proof of claim.

(3) Time limitations. – No claim of a customer or other creditor of the debtor which is received by the trustee after the expiration of the six-month period beginning on the date of publication of notice under paragraph (1) shall be allowed, except that the court may, upon application within such period and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian. Any claim of a customer for net equity which is received by the trustee after the expiration of such period of time as may be fixed by the court (not exceeding sixty days after the date of publication of notice under paragraph (1)) need not be paid or satisfied in

whole or in part out of customer property, and, to the extent such claim is satisfied from moneys advanced by SIPC, it shall be satisfied in cash or securities (or both) as the trustee determines is most economical to the estate.

(4) Effect on claims. – Except as otherwise provided in this section, and without limiting the powers and duties of the trustee to discharge obligations promptly as specified in this section, nothing in this section shall limit the right of any person, including any subrogee, to establish by formal proof or otherwise as the court may provide such claims as such person may have against the debtor, including claims for the payment of money and the delivery of specific securities, without resort to moneys advanced by SIPC to the trustee.

(b) Payments to customers. – After receipt of a written statement of claim pursuant to subsection (a)(2) of this section, the trustee shall promptly discharge, in accordance with the provisions of this section, all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash, by the delivery of securities or the making of payments to or for the account of such customer (subject to the provisions of subsection (d) of this section and section 78fff-3(a) of this title) insofar as such obligations are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the filing date. For purposes of this subsection, the court shall, among other things–

(1) with respect to net equity claims, authorize the trustee to satisfy claims out of

moneys made available to the trustee by SIPC notwithstanding the fact that there has not been any showing or determination that there are sufficient funds of the debtor available to satisfy such claims; and

(2) with respect to claims relating to, or net equities based upon, securities of a class and series of an issuer which are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee authorize the trustee to deliver securities of such class and series if and to the extent available to satisfy such claims in whole or in part, with partial deliveries to be made pro rata to the greatest extent considered practicable by the trustee.

Any payment or delivery of property pursuant to this subsection may be conditioned upon the trustee requiring claimants to execute, in a form to be determined by the trustee, appropriate receipts, supporting affidavits, releases, and assignments, but shall be without prejudice to any right of a claimant to file formal proof of claim within the period specified in subsection (a)(3) of this section for any balance of securities or cash to which such claimant considers himself entitled.

(c) Customer related property. –

(1) Allocation of customer property. – The trustee shall allocate customer property of the debtor as follows:

(A) first, to SIPC in repayment of advances made by SIPC pursuant to section 78fff-3(c)(1) of this title, to the extent such advances recovered securities which were apportioned to customer property pursuant to section 78fff(d) of this title;

(B) second, to customers of such debtor, who shall share ratably in such customer property on the basis and to the extent of their respective net equities;

(C) third, to SIPC as subrogee for the claims of customers;

(D) fourth, to SIPC in repayment of advances made by SIPC pursuant to section 78fff-3(c)(2) of this title.

Any customer property remaining after allocation in accordance with this paragraph shall become part of the general estate of the debtor. To the extent customer property and SIPC advances pursuant to section 78fff-3(a) of this title are not sufficient to pay or otherwise satisfy in full the net equity claims of customers, such customers shall be entitled, to the extent only of their respective unsatisfied net equities, to participate in the general estate as unsecured creditors. For purposes of allocating customer property under this paragraph, securities to be delivered in payment of net equity claims for securities of the same class and series of an issuer shall be valued as of the close of business on the filing date.

(2) Delivery of customer name securities. – The trustee shall deliver customer name securities to or on behalf of a customer of the debtor entitled thereto if the customer is not indebted to the debtor. If the customer is so indebted, such customer may, with the approval of the trustee, reclaim customer name securities upon payment to the trustee, within such period of time as the trustee determines, of all indebtedness of such customer to the debtor.

(3) Recovery of transfers. – Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through

(D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of Title 11. Such recovered property shall be treated as customer property. For purposes of such recovery, the property so transferred shall be deemed to have been the property of the debtor and, if such transfer was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding.

(d) Purchase of securities. – The trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities based on securities under section 78fff-1(b)(1) of this title and for the transfer of customer accounts under subsection (f) of this section, in order to restore the accounts of such customers as of the filing date. To the extent consistent with subsection (c) of this section, customer property and moneys advanced by SIPC may be used by the trustee to pay for securities so purchased. Moneys advanced by SIPC for each account of a separate customer may not be used to purchase securities to the extent that the aggregate value of such securities on the filing date exceeded the amount permitted to be advanced by SIPC under the provisions of section 78fff-3(a) of this title.

(e) Closeouts. –

(1) In general. – Any contract of the debtor for the purchase or sale of securities in the ordinary course of its business with other brokers or dealers which is wholly executory on the filing

date shall not be completed by the trustee, except to the extent permitted by SIPC rule. Upon the adoption by SIPC of rules with respect to the closeout of such a contract but prior to the adoption of rules with respect to the completion of such a contract, the other broker or dealer shall close out such contract, without unnecessary delay, in the best available market and pursuant to such SIPC rules. Until such time as SIPC adopts rules with respect to the completion or closeout of such a contract, such a contract shall be closed out in accordance with Commission Rule S6(d)-1 as in effect on May 21, 1978, or any comparable rule of the Commission subsequently adopted, to the extent not inconsistent with the provision of this subsection.

(2) Net profit or loss. – A broker or dealer shall net all profits and losses on all contracts closed out under this subsection and –

(A) if such broker or dealer shows a net profit on such contracts, he shall pay such net profit to the trustee; and

(B) if such broker or dealer sustains a net loss on such contracts, he shall be entitled to file a claim against the debtor with the trustee in the amount of such net loss.

To the extent that a net loss sustained by a broker or dealer arises from contracts pursuant to which such broker or dealer was acting for its own customer, such broker or dealer shall be entitled to receive funds advanced by SIPC to the trustee in the amount of such loss, except that such broker or dealer may not receive more than $40,000 for each separate customer with respect to whom it sustained a loss. With respect to a net loss which is not payable under the preceding sentence from funds advanced by SIPC, the broker or dealer shall

be entitled to participate in the general estate as an unsecured creditor.

(3) Registered clearing agencies. – Neither a registered clearing agency which by its rules has an established procedure for the closeout of open contracts between an insolvent broker or dealer and its participants, nor its participants to the extent such participants' claims are or may be processed within the registered clearing agency, shall be entitled to receive SIPC funds in payment of any losses on such contracts, except as SIPC may otherwise provide by rule. If such registered clearing agency or its participants sustain a net loss on the closeout of such contracts with the debtor, they shall have the right to participate in the general estate as unsecured creditors to the extent of such loss. Any funds or other property owed to the debtor, after the closeout of such contracts, shall be promptly paid to the trustee. Rules adopted by SIPC under this paragraph shall provide that in no case may a registered clearing agency or its participants, to the extent such participants' claims are or may be processed within the registered clearing agency, be entitled to receive funds advanced by SIPC in an amount greater, in the aggregate, than could be received by the participants if such participants proceeded individually under paragraphs (1) and (2).

(4) Definition. – For purposes of this subsection, the term "customer" does not include any person who –

(A) is a broker or dealer;

(B) had a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, was part of the capital of the claiming broker or dealer

or was subordinated to the claims of any or all creditors of such broker or dealer; or

(C) had a relationship of the kind specified in section 78fff-3(a)(5) of this title with the debtor.

A claiming broker or dealer shall be deemed to have been acting on behalf of its customer if it acted as agent for such customer or if it held such customer's order which was to be executed as a part of its contract with the debtor.

(f) Transfer of customer accounts. In order to facilitate the prompt satisfaction of customer claims and the orderly liquidation of the debtor, the trustee may, pursuant to the terms satisfactory to him and subject to the prior approval of SIPC, sell or otherwise transfer to another member of SIPC, without consent of any customer, all or any part of the account of a customer of the debtor. In connection with any such sale or transfer to another member of SIPC and subject to the prior approval of SIPC, the trustee may –

(1) waive or modify the need to file a written statement of claim pursuant to subsection (a)(2) of this section; and

(2) enter into such agreements as the trustee considers appropriate under the circumstances to indemnify any such member of SIPC against shortages of cash or securities in the customer accounts sold or transferred.

The funds of SIPC may be made available to guarantee or secure any indemnification under paragraph (2). The prior approval of SIPC to such indemnification shall be conditioned, among such other standards as SIPC may

determine, upon a determination by SIPC that the probable cost of any such indemnification can reasonably be expected not to exceed the cost to SIPC of proceeding under section 78fff-3(a) of this title and section 78fff-3(b) of this title.

§ 78fff-3. SIPC advances

(a) Advances for customers' claims. – In order to provide for prompt payment and satisfaction of net equity claims of customers of the debtor, SIPC shall advance to the trustee such moneys, not to exceed $500,000 for each customer, as may be required to pay or otherwise satisfy claims for the amount by which the net equity of each customer exceeds his ratable share of customer property, except that –

(1) if all or any portion of the net equity claim of a customer in excess of his ratable share of customer property is a claim for cash, as distinct from a claim for securities, the amount advanced to satisfy such claim for cash shall not exceed $100,000 for each such customer;

(2) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(3) if all or any portion of the net equity claim of a customer in excess of his ratable share of customer property is satisfied by the delivery of securities purchased by the trustee pursuant to section 78fff-2(d) of this title, the securities so purchased shall be valued as of the filing date for purposes of applying the dollar limitations of this subsection;

(4) no advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any net equity claim of a customer who is a general partner, officer, or director of the debtor, a beneficial owner of five per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights), a limited partner with a participation of five per centum or more in the net assets or net profits of the debtor, or a person who, directly or indirectly and through agreement or otherwise, exercised or had the power to exercise a controlling influence over the management or policies of the debtor; and

(5) no advance shall be made by SIPC to the trustee to pay or otherwise satisfy any net equity claim of any customer who is a broker or dealer or bank, other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank, or otherwise, that the net equity claim of such broker or dealer or bank against the debtor arose out of transactions for customers of such broker or dealer or bank (which customers are not themselves a broker or dealer or bank or a person described in paragraph (4)), in which event each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

To the extent moneys are advanced by SIPC to the trustee to pay or otherwise satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this chapter, except that SIPC as subrogee may assert no claim against

customer property until after the allocation thereof to customers as provided in section 78fff-2(c) of this title.

(b) Other advances. – SIPC shall advance to the trustee –

(1) such moneys as may be required to carry out section 78fff-2(e) of this title; and

(2) to the extent the general estate of the debtor is not sufficient to pay any and all costs and expenses of administration of the estate of the debtor and of the liquidation proceeding, the amount of such costs and expenses.

(c) Discretionary advances. – SIPC may advance to the trustee such moneys as may be required to –

(1) pay or guarantee indebtedness of the debtor to a bank, lender, or other person under section 78fff-1(b)(2) of this title;

(2) guarantee or secure any indemnity under section 78fff-2(f) of this title; and

(3) purchase securities under section 78fff-2(d) of this title.

§ 78fff-4. Direct payment procedure

(a) Determination regarding direct payments. – If SIPC determines that –

(1) any member of SIPC (including a person who was a member within one hundred eighty days prior to such determination) has failed or is in danger of failing to meet its obligations to customers;

(2) one or more of the conditions specified in section 78eee(b)(1) of this title exist with respect to such member;

(3) the claim of each customer of the member is within the limits of protection provided in section 78fff-3(a) of this title;

(4) the claims of all customers of the member aggregate less than $250,000;

(5) the cost to SIPC of satisfying customer claims under this section will be less than the cost under a liquidation proceeding; and

(6) such member's registration as a broker-dealer under section 78*o*(b) of this title has been terminated, or such member has consented to the use of the direct payment procedure set forth in this section,

SIPC may, in its discretion, use the direct payment procedure set forth in this section in lieu of instituting a liquidation proceeding with respect to such member.

(b) Notice. – Promptly after a determination under subsection (a) of this section that the direct payment procedure is to be used with respect to a member, SIPC shall cause notice of such direct payment procedure to be published in one or more newspapers of general circulation in a form and manner determined by SIPC, and at the same time shall cause to be mailed a copy of such notice to each person who appears, from the books and records of such member, to have been a customer of the member with an open account within the past twelve months, to the address of such person as it appears from the books and records of such member. Such notice shall state that SIPC will satisfy customer claims directly, without a liquidation proceeding, and shall set forth the form and manner in which claims may be presented. A direct payment procedure shall be deemed to commence on the date of first publication under this subsection and no

claim by a customer shall be paid or otherwise satisfied by SIPC unless received within the six-month period beginning on such date, except that SIPC shall, upon application within such period, and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian.

(c) Payments to customers. – SIPC shall promptly satisfy all obligations of the member to each of its customers relating to, or net equity claims based upon, securities or cash by the delivery of securities or the effecting of payments to such customer (subject to the provisions of section 78fff-2(d) of this title and section 78fff-3(a) of this title) insofar as such obligations are ascertainable from the books and records of the member or are otherwise established to the satisfaction of SIPC. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the date of publication under subsection (b) of this section. Any payment or delivery of securities pursuant to this section may be conditioned upon the execution and delivery, in a form to be determined by SIPC, of appropriate receipts, supporting affidavits, releases, and assignments. To the extent moneys of SIPC are used to satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers against the member.

(d) Effect on claims. – Except as otherwise provided in this section, nothing in this section shall limit the right of any person, including any subrogee, to establish by formal proof or otherwise such claims as such person

may have against the member, including claims for the payment of money and the delivery of specific securities, without resort to moneys of SIPC.

(e) Jurisdiction of Bankruptcy Courts. – After SIPC has published notice of the institution of a direct payment procedure under this section, any person aggrieved by any determination of SIPC with respect to his claim under subsection (c) of this section may, within six months following mailing by SIPC of its determination with respect to such claim, seek a final adjudication of such claim. The courts of the United States having jurisdiction over cases under Title 11 shall have original and exclusive jurisdiction of any civil action for the adjudication of such claim. Any such action shall be brought in the judicial district where the head office of the debtor is located. Any determination of the rights of a customer under subsection (c) of this section shall not prejudice any other right or remedy of the customer against the member.

(f) Discontinuance of direct payment procedures. – If, at any time after the institution of a direct payment procedure with respect to a member, SIPC determines, in its discretion, that continuation of such direct payment procedure is not appropriate, SIPC may cease such direct payment procedure and, upon so doing, may seek a protective decree pursuant to section 78eee of this title. To the extent payments of cash, distributions of securities, or determinations with respect to the validity of a customer's claim are made under this section, such payments, distributions, and determinations shall be recognized and given full effect in the event of any subsequent liquidation proceeding. Any action brought under

subsection (e) of this section and pending at the time of the appointment of a trustee under section 78eee(b)(3) of this title shall be permanently stayed by the court at the time of such appointment, and the court shall enter an order directing the transfer or removal to it of such suit. Upon such removal or transfer the complaint in such action shall constitute the plaintiff's claim in the liquidation proceeding, if appropriate, and shall be deemed received by the trustee on the date of his appointment regardless of the date of actual transfer or removal of such action.

(g) References. – For purposes of this section, any reference to the trustee in sections 78fff-1(b)(1), 78fff-2(d), 78fff-2(f), 78fff-3(a), 78*lll*(5) and 78*lll*(12) of this title shall be deemed a reference to SIPC, and any reference to the date of publication of notice under section 78fff-2(a) of this title shall be deemed a reference to the publication of notice under this section.

§ 78ggg. SEC functions

(a) Administrative procedure. – Determinations of the Commission, for purposes of making rules pursuant to section 78ccc(e)(3) of this title and section 78iii(f) of this title shall be after appropriate notice and opportunity for a hearing, and for submission of views of interested persons, in accordance with the rulemaking procedures specified in section 553 of Title 5, but the holding of a hearing shall not prevent adoption of any such rule or regulation upon expiration of the notice period specified in subsection (d) of such section and shall not be required

to be on a record within the meaning of subchapter II of chapter 5 of such title.

(b) Enforcement of actions. – In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this chapter and for such other relief as the court may deem appropriate to carry out the purposes of this chapter.

(c) Examinations and reports. –

(1) Examination of SIPC, etc. – The Commission may make such examinations and inspections of SIPC and require SIPC to furnish it with such reports and records or copies thereof as the Commission may consider necessary or appropriate in the public interest or to effectuate the purposes of this chapter.

(2) Reports from SIPC. – As soon as practicable after the close of each fiscal year, SIPC shall submit to the Commission a written report relative to the conduct of its business, and the exercise of the other rights and powers granted by this chapter, during such fiscal year. Such report shall include financial statements setting forth the financial position of SIPC at the end of such fiscal year and the results of its operations (including the source and application of its funds) for such fiscal year. The financial statements so included shall be examined by an independent public accountant or firm of independent public accountants, selected by SIPC and satisfactory to the Commission, and shall be accompanied by the report thereon of such accountant or firm. The Commission shall

transmit such report to the President and the Congress with such comment thereon as the Commission may deem appropriate.

§ 78hhh. Examining authority functions

Each member of SIPC shall file with such member's examining authority, or collection agent if a collection agent has been designated pursuant to section 78iii(a) of this title, such information (including reports of, and information with respect to, the gross revenues from the securities business of such member, including the composition thereof, transactions in securities effected by such member, and other information with respect to such member's activities, whether in the securities business or otherwise, including customer accounts maintained, net capital employed, and activities conducted) as SIPC may determine to be necessary or appropriate for the purpose of making assessments under section 78ddd of this title. The examining authority or collection agent shall file with SIPC all or such part of such information (and such compilations and analyses thereof) as SIPC, by bylaw or rule, shall prescribe. No application, report, or document filed pursuant to this section shall be deemed to be filed pursuant to section 78r of this title.

§ 78iii. Functions of self-regulatory organizations

(a) Collection agent. – Each self-regulatory organization shall act as collection agent for SIPC to collect the assessments payable by all members of SIPC for whom such self-regulatory organization is the examining

authority, unless SIPC designates a self-regulatory organization other than the examining authority to act as collection agent for any member of SIPC who is a member of or participant in more than one self regulatory organization. If the only self-regulatory organization of which a member of SIPC is a member or in which it is a participant is a registered clearing agency that is not the examining authority for the member, SIPC may, nevertheless, designate such registered clearing agency as collection agent for the member or may require that payments be made directly to SIPC. The collection agent shall be obligated to remit to SIPC assessments made under section 78ddd of this title only to the extent that payments of such assessment are received by such collection agent. Members of SIPC who are not members of or participants in a self-regulatory organization shall make payments directly to SIPC.

(b) Immunity. – No self-regulatory organization shall have any liability to any person for any action taken or omitted in good faith pursuant to Section 78eee(a)(1) and Section 78eee(a)(2) of this title.

(c) Inspections. – The self-regulatory organization of which a member of SIPC is a member or in which it is a participant shall inspect or examine such member for compliance with applicable financial responsibility rules, except that –

(1) if the self-regulatory organization is a registered clearing agency, the Commission may designate itself as responsible for the examination of such member for compliance with applicable financial responsibility rules; and

(2) if a member of SIPC is a member of or participant in more than one self-regulatory organization, the Commission, pursuant to section 78q(d) of this title, shall designate one of such self-regulatory organizations or itself as responsible for the examination of such member for compliance with applicable financial responsibility rules.

(d) Reports. – There shall be filed with SIPC by the self-regulatory organizations such reports of inspections or examinations of the members of SIPC (or copies thereof) as may be designated by SIPC by bylaw or rule.

(e) Consultation. – SIPC shall consult and cooperate with the self-regulatory organizations toward the end:

(1) that there may be developed and carried into effect procedures reasonably designed to detect approaching financial difficulty upon the part of any member of SIPC;

(2) that, as nearly as may be practicable, examinations to ascertain whether members of SIPC are in compliance with applicable financial responsibility rules will be conducted by the self-regulatory organizations under appropriate standards (both as to method and scope) and reports of such examinations will, where appropriate, be standard in form; and

(3) that, as frequently as may be practicable under the circumstances, each member of SIPC will file financial information with, and be examined by, the self-regulatory organization which is the examining authority for such member.

(f) Financial condition of members. – The Commission may, by such rules as it determines necessary or appropriate in the public interest and to carry out the

purposes of this chapter, require any self-regulatory organization to furnish SIPC with reports and records (or copies thereof) relating to the financial condition of members of or participants in such self-regulatory organization.

§ 78jjj. Prohibited acts

(a) Failure to pay assessment, etc. – If a member of SIPC shall fail to file any report or information required pursuant to this chapter, or shall fail to pay when due all or any part of an assessment made upon such member pursuant to this chapter, and such failure shall not have been cured, by the filing of such report or information or by the making of such payment, together with interest and penalty thereon, within five days after receipt by such member of written notice of such failure given by or on behalf of SIPC, it shall be unlawful for such member, unless specifically authorized by the Commission, to engage in business as a broker or dealer. If such member denies that it owes all or any part of the amount specified in such notice, it may after payment of the full amount so specified commence an action against SIPC in the appropriate United States district court to recover the amount it denies owing.

(b) Engaging in business after appointment of trustee or initiation of direct payment procedure. – It shall be unlawful for any broker or dealer for whom a trustee has been appointed pursuant to this chapter or for whom a direct payment procedure has been initiated to engage thereafter in business as a broker or dealer, unless

the Commission otherwise determines in the public interest. The Commission may by order bar or suspend for any period, any officer, director, general partner, owner of 10 per centum or more of the voting securities, or controlling person of any broker or dealer for whom a trustee has been appointed pursuant to this chapter or for whom a direct payment procedure has been initiated from being or becoming associated with a broker or dealer, if after appropriate notice and opportunity for hearing, the Commission shall determine such bar or suspension to be in the public interest.

(c) Concealment of assets; false statements or claims. –

(1) Specific prohibited acts. – Any person who, directly or indirectly, in connection with or in contemplation of any liquidation proceeding or direct payment procedure –

(A) employs any device, scheme, or artifice to defraud;

(B) engages in any act, practice, or course of business which operates or would operate as fraud or deceit upon any person; or

(C) fraudulently or with intent to defeat this chapter –

(i) conceals or transfers any property belonging to the estate of a debtor;

(ii) makes a false statement or account;

(iii) presents or uses any false claim for proof against the estate of a debtor;

(iv) receives any material amount of property from a debtor;

(v) gives, offers, receives, transfers, or obtains any money or property, remuneration, compensation, reward, advantage, other consideration, or promise thereof, for acting or forbearing to act;

(vi) conceals, destroys, mutilates, falsifies, makes a false entry in, or otherwise falsifies any document affecting or relating to the property or affairs of a debtor; or

(vii) withholds, from any person entitled to its possession, any document affecting or relating to the property or affairs of a debtor,

shall be fined not more than $50,000 or imprisoned for not more than five years, or both.

(2) Fraudulent conversion. – Any person who, directly or indirectly steals, embezzles, or fraudulently, or with intent to defeat this chapter, abstracts or converts to his own use or to the use of another any of the moneys, securities, or other assets of SIPC, or otherwise defrauds or attempts to defraud SIPC or a trustee by any means, shall be fined not more than $50,000 or imprisoned not more than five years, or both.

§ 78kkk. Miscellaneous provisions

(a) Public inspection of reports. – Any notice, report, or other document filed with SIPC pursuant to this chapter shall be available for public inspection unless SIPC or the Commission shall determine that disclosure thereof is not in the public interest. Nothing herein shall act to deny documents or information to the Congress of

the United States or the committees of either House having jurisdiction over financial institutions, securities regulation, or related matters under the rules of each body. Nor shall the Commission be denied any document or information which the Commission, in its judgment, needs.

(b) Liability of members of SIPC. – Except for such assessments as may be made upon such member pursuant to the provisions of section 78ddd of this title, no member of SIPC shall have any liability under this chapter as member of SIPC for, or in connection with, any act or omission of any other broker or dealer whether in connection with the conduct of the business or affairs of such broker or dealer or otherwise and, without limiting the generality of the foregoing, no member shall have any liability for or in respect of any indebtedness or other liability of SIPC.

(c) Liability of SIPC and Directors, officers, or employees. – Neither SIPC nor any of its Directors, officers, or employees shall have any liability to any person for any action taken or omitted in good faith under or in connection with any matter contemplated by this chapter.

(d) Advertising. – SIPC shall by bylaw prescribe the manner in which a member of SIPC may display any sign or signs (or include in any advertisement a statement) relating to the protection to customers and their accounts, or any other protections, afforded under this chapter. No member may display any such sign, or include in an advertisement any such statement, except in accordance with such bylaws. SIPC may also by bylaw prescribe such minimal requirements as it considers necessary and

appropriate to require a member of SIPC to provide public notice of its membership in SIPC.

(e) SIPC exempt from taxation. – SIPC, its property, its franchise, capital, reserves, surplus, and its income, shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority, except that any real property and any tangible personal property (other than cash and securities) of SIPC shall be subject to State and local taxation to the same extent according to its value as other real and tangible personal property is taxed. Assessments made upon a member of SIPC shall constitute ordinary and necessary expenses in carrying on the business of such member for the purpose of section 162(a) of Title 26. The contribution and transfer to SIPC of funds or securities held by any trust established by a national securities exchange prior to January 1, 1970, for the purpose of providing assistance to customers of members of such exchange, shall not result in any taxable gain to such trust or give rise to any taxable income to any member of SIPC under any provision of Title 26, nor shall such contribution or transfer, or any reduction in assessments made pursuant to this chapter, in any way affect the status, as ordinary and necessary expenses under section 162(a) of Title 26, of any contributions made to such trust by such exchange at any time prior to such transfer. Upon dissolution of SIPC, none of its net assets shall inure to the benefit of any of its members.

(f) Section 78t(a) of this title not to apply. – The provisions of subsection (a) of section 78t of this title shall not apply to any liability under or in connection with this chapter.

(g) SEC study of unsafe or unsound practices. – Not later than twelve months after December 30, 1970, the Commission shall compile a list of unsafe or unsound practices by members of SIPC in conducting their business and report to the Congress (1) the steps being taken under the authority of existing law to eliminate those practices and (2) recommendations concerning additional legislation which may be needed to eliminate those unsafe or unsound practices.

§ 78*lll*. Definitions

For purposes of this chapter including the application of the Bankruptcy Act to a liquidation proceeding:

(1) Commission. – The term "Commission" means the Securities and Exchange Commission.

(2) Customer. – The term "customer" of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security, or for purposes of effecting transfer. The term "customer" includes any person who has a claim against the debtor arising out of sales or conversions of such securities, and any person who has deposited cash with the debtor for the purpose of purchasing securities, but does not include –

(A) any person to the extent that the claim of such person arises out of transactions with a foreign subsidiary of a member of SIPC; or

(B) any person to the extent that such person has a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor, or is subordinated to the claims of any or all creditors of the debtor, notwithstanding that some ground exists for declaring such contract, agreement, or understanding void or voidable in a suit between the claimant and the debtor.

(3) Customer name securities. – The term "customer name securities" means securities which were held for the account of a customer on the filing date by or on behalf of the debtor and which on the filing date were registered in the name of the customer, or were in the process of being so registered pursuant to instructions from the debtor, but does not include securities registered in the name of the customer which, by endorsement or otherwise, were in negotiable form.

(4) Customer property. – The term "customer property" means cash and securities (except customer name securities delivered to the customer) at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted. The term "customer property" includes –

(A) securities held as property of the debtor to the extent that the inability of the debtor to meet its obligations to customers

for their net equity claims based on securities of the same class and series of an issuer is attributable to the debtor's noncompliance with the requirements of section 78*o*(c)(3) of this title and the rules prescribed under such section;

(B) resources provided through the use or realization of customers' debit cash balances and other customer-related debit items as defined by the Commission by rule;

(C) any cash or securities apportioned to customer property pursuant to section 78fff(d) of this title; and

(D) any other property of the debtor which, upon compliance with applicable laws, rules, and regulations, would have been set aside or held for the benefit of customers, unless the trustee determines that including such property within the meaning of such term would not significantly increase customer property.

(5) Debtor. – The term "debtor" means a member of SIPC with respect to whom an application for a protective decree has been filed under section 78eee(a)(3) of this title or a direct payment procedure has been instituted under section 78fff-4(b) of this title.

(6) Examining authority. – The term "examining authority" means, with respect to any member of SIPC (A) the self-regulatory organization which inspects or examines such member of SIPC, or (B) the Commission if such member of SIPC is not a member of or participant in any self-regulatory organization or if the Commission has designated itself examining authority for such member pursuant to section 78iii(c) of this title.

(7) Filing date. – The term "filing date" means the date on which an application for a protective decree is filed under section 78eee(a)(3) of this title, except that –

(A) if a petition under Title 11 concerning the debtor was filed before such date, the term "filing date" means the date on which such petition was filed;

(B) if the debtor is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term "filing date" means the date on which such proceeding was commenced; or

(C) if the debtor is the subject of a direct payment procedure or was the subject of a direct payment procedure discontinued by SIPC pursuant to section 78fff-4(f) of this title, the term "filing date" means the date on which notice of such direct payment procedure was published under section 78fff-4(b) of this title.

(8) Foreign subsidiary. – The term "foreign subsidiary" means any subsidiary of a member of SIPC which has its principal place of business in a foreign country or which is organized under the laws of a foreign country.

(9) Gross revenues from the securities business. – The term "gross revenues from the securities business" means the sum of (but without duplication) –

(A) commissions earned in connection with transactions in securities effected for customers as agent (net of commissions

paid to other brokers and dealers in connection with such transactions) and markups with respect to purchases or sales of securities as principal;

(B) charges for executing or clearing transactions in securities for other brokers and dealers;

(C) the net realized gain, if any, from principal transactions in securities in trading accounts;

(D) the net profit, if any, from the management of or participation in the underwriting or distribution of securities;

(E) interest earned on customers' securities accounts;

(F) fees for investment advisory services (except when rendered to one or more registered investment companies or insurance company separate accounts) or account supervision with respect to securities;

(G) fees for the solicitation of proxies with respect to, or tenders or exchanges of, securities;

(H) income from service charges or other surcharges with respect to securities;

(I) except as otherwise provided by rule of the Commission, dividends and interest received on securities in investment accounts of the broker or dealer;

(J) fees in connection with put, call, and other option transactions in securities;

(K) commissions earned from transactions in (i) certificates of deposit, and (ii) Treasury bills, bankers acceptances, or commercial paper which have a maturity at the

time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited, except that SIPC shall by bylaw include in the aggregate of gross revenues only an appropriate percentage of such commissions based on SIPC's loss experience with respect to such instruments over at least the preceding five years; and

(L) fees and other income from such other categories of the securities business as SIPC shall provide by bylaw.

Such term does not include revenues received by a broker or dealer in connection with the distribution of shares of a registered open end investment company or unit investment trust or revenues derived by a broker or dealer from the sale of variable annuities or from the conduct of the business of insurance.

(10) Liquidation proceeding. – The term "liquidation proceeding" means any proceeding for the liquidation of a debtor under this chapter in which a trustee has been appointed under section 78eee(b)(3) of this title.

(11) Net equity. – The term "net equity" means the dollar amount of the account or accounts of a customer, to be determined by –

(A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer (other than customer name securities reclaimed by such customer); minus

(B) any indebtedness of such customer to the debtor on the filing date; plus

(C) any payment by such customer of such indebtedness to the debtor which is made with the approval of the trustee and within such period as the trustee may determine (but in no event more than sixty days after the publication of notice under section 78fff-2(a) of this title).

In determining net equity under this paragraph, accounts held by a customer in separate capacities shall be deemed to be accounts of separate customers.

(12) Persons registered as brokers or dealers. – The term "persons registered as brokers or dealers" includes any person who is a member of a national securities exchange other than a government securities broker or government securities dealer registered under section 78*o*-5(a)(1)(A) of this title.

(13) Protective decree. – The term "protective decree" means a decree, issued by a court upon application of SIPC under section 78eee(a)(3) of this title, that the customers of a member of SIPC are in need of the protection provided under this chapter.

(14) Security. – The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, any collateral trust certificate, preorganization certificate or subscription, transferable share, voting trust certificate, certificate of deposit, certificate of deposit for a security, any investment contract or certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or mineral royalty or lease (if such investment contract or interest is the subject of a registration statement with the Commission pursuant to the provisions of the Securities Act of 1933 [15 U.S.C.A. § 77a et

seq.]), any put, call, straddle, option, or privilege on any security, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase or sell any of the foregoing, and any other instrument commonly known as a security. Except as specifically provided above, the term "security" does not include any currency, or any commodity or related contract or futures contract, or any warrant or right to subscribe to or purchase or sell any of the foregoing.

SECURITIES EXCHANGE ACT OF 1934, SECTION 10(b)
(15 U.S.C. § 78j(b))

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility or any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SECURITIES AND EXCHANGE COMMISSION RULE 10b-5
(17 C.F.R. § 240.10b-5)

§ 240.10b-5. Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

SECURITIES EXCHANGE ACT OF 1934, Section 32 (15 U.S.C. § 78ff)

(a) Willful violations; false and misleading statements

Any person who wilfully violates any provision of this chapter (other than section 78dd-1 of this title), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $1,000,000 or imprisoned not more than 10 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $2,500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

(b) Failure to file information, documents, or reports

Any issuer which fails to file information, documents, or reports required to be filed under subsection (d) of section 78*o* of this title or any rule or regulation thereunder shall forfeit to the United States the sum of $100 for each and every day such failure to file shall continue.

Such forfeiture, which shall be in lieu of any criminal penalty for such failure to file which might be deemed to arise under subsection (a) of this section, shall be payable into the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States.

(c) Violations by issuers, officers, directors, stockholders, employees, or agents of issuers

(1)(A) Any issuer that violates section 78dd-1(a) of this title shall be fined no more than $2,000,000.

(B) Any issuer that violates section 78dd-1(a) of this title shall be subject to a civil penalty of not more than $10,000 imposed in an action brought by the Commission.

(2)(A) Any officer or director of an issuer, or stockholder acting on behalf of such issuer, who willfully violates section 76dd-1(a) of this title shall be fined not more than $100,000, or imprisoned not more than 5 years, or both.

(B) Any employee or agent of an issuer who is a United States citizen, national, or resident or is otherwise subject to the jurisdiction of the United States (other than an officer, director, or stockholder acting on behalf of such issuer), and who willfully violates section 78dd-1(a) of this title shall be fined not more than $100,000, or imprisoned not more than 5 years, or both.

(C) Any officer, director, employee, or agent of an issuer, or stockholder acting on behalf of such issuer, who violates section 78dd-1(a) of this title shall be subject to a

civil penalty of not more than $10,000 imposed in an action brought by the Commission.

(3) Whenever a fine is imposed under paragraph (2) upon any officer, director, employee, agent or stockholder of an issuer, such fine may not be paid, directly or indirectly by such issuer.

Supreme Court, U.S.
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No. 90-727

In The

Supreme Court of the United States

October Term, 1991

ROBERT G. HOLMES, JR.,

Petitioner,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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INTRODUCTION

In its opposition brief (the "SIPC Brief"), the Securities Investor Protection Corporation ("SIPC") avoids acknowledging the import of the express language of §1964(c) of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-68 ("RICO"), that a plaintiff must show "injury to his business or property" caused "by reason of" a "fraud in the sale of securities." It is from the direct application of these concepts that the civil RICO standing requirement of purchaser or seller status is derived.

Instead, SIPC misreads the statute to ignore the key phrases and focuses attention on a host of false issues. SIPC argues that Petitioner Robert G. Holmes, Jr. ("Holmes") departs from the express language of the statute, that Holmes has advanced certain questionable "myths," and that, because of an epidemic of serious business fraud in the United States, SIPC should be given special indulgence to remedy it. These arguments lack merit and do not assist in resolution of the question before this Court. SIPC also inappropriately invites the exercise of legislative discretion by this Court, to allow SIPC to act as a self-styled vigilante prosecutor of business fraud, free of statutory requirements, when neither the Securities Investor Protection Act of 1970, 15 U.S.C. §§78aaa-78lll ("SIPA"), nor RICO authorize or contemplate such activities. SIPC's invitation to misread §1964(c) and create special RICO standing for SIPC to comport with SIPC's view of its own mission, at the expense of plain statutory language and settled legal precedent, should not be accepted by this Court.

ARGUMENT

I.

SIPC IS NOT A PERSON THAT HAS BEEN "INJURED IN HIS BUSINESS OR PROPERTY."

As a procedural matter, SIPC erroneously claims that Holmes has raised the argument that SIPC is not a person "injured in his business or property" for the first time in the Petitioner's Brief ("Holmes Brief") (SIPC Brief, p. 36). In fact, Holmes raised this argument previously in Holmes' Petition for Certiorari ("Cert. Petition") at page 11, text and footnote 12.[1] Accordingly, the argument is properly included in the Holmes Brief on the merits pursuant to Supreme Court Rule 24(1)(a). Moreover, SIPC did not object in its opposition to the Cert. Petition that the argument concerning injury to business or property was newly raised. Since the language that a person be "injured in his business or property" is contained expressly in the text of RICO §1964(c), the matter can hardly be said to be new.

On the merits, in the opposition brief, SIPC was unable to demonstrate that it was directly injured in its "business or property." Although SIPC claims that it has standing as "a party in interest to all matters" under SIPA (SIPC Brief, p. 37), the standards of RICO §1964(c), not

[1] Additionally, in Holmes' Ninth Circuit Brief below, Holmes cited *Int'l Data Bank Ltd. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987), which discussed "injury" to "business or property" as a requirement of civil RICO standing. (*See* Holmes' Ninth Circuit Brief, p. 67, ns. 193, 194, 199, 200, 201, 202, 203).

those of SIPA, are applicable to determine standing here. SIPC argues that it acquired subrogation rights when it paid money to customers of the failed brokerage firms. (SIPC Brief, p. 37-39). The claims to which SIPC is subrogated, however, were held by customers of the defunct brokerage firms who did not purchase the allegedly manipulated securities and are not cognizable claims against Holmes under securities laws. RICO claims against Holmes, held by customers of the failed brokerage firms who purchased the allegedly manipulated securities, have already been asserted in a companion class action.[2]

To note that SIPC's "injury" consists of "advances made to the Trustees" of the defunct brokerage firms (SIPC Brief, p. 36) does not suffice to establish SIPC as a directly injured victim. (*See* Holmes Brief, pp. 9-16). SIPC does not dispute that only the directly injured party has standing to invoke civil RICO. Here, the direct victims of the alleged racketeering activity were open market purchasers and sellers of the allegedly manipulated securities and the failed security brokerage firms, not SIPC. SIPC arrived on the scene to provide aid and assistance after the damage had already been done. (*See* Holmes Brief, pp. 14-16).

II.

SIPC WAS NOT INJURED "BY REASON OF" THE ALLEGED FRAUD.

Holmes has argued that one who was not a purchaser or seller of securities could not have been injured under

[2] District Court Clerk's Record 475 (*Cain v. Vigman*, No. 83-5674 AWT (Tx) Complaint, pp. 116-118, parag. 246-254).

RICO "by reason of" alleged predicate violations of Section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §78j(b) ("Exchange Act") and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. §240.10b-5 ("Rule 10b-5") thereunder. However, SIPC contends that the argument that civil RICO standing requires that a person who has been injured must have been injured "by reason of" the alleged racketeering activity is not before this Court because certiorari was granted "limited to Question 1 presented by the petition" (SIPC Brief, p. 34), and was not granted with respect to Question 2.

Since the "by reason of" language and requirement is contained on the face of §1964(c), the question on civil RICO standing, as to which this Court granted certiorari, of necessity encompasses an analysis of the phrase.

Question No. 2 in the Cert. Petition, as to which certiorari was not granted, related to whether liability "may be imposed against a defendant, as a co-conspirator, when his own conduct has no causal connection to the harm sustained by the plaintiff." (Cert. Petition, page (i)).[3] The inquiry in Question No. 1, as it relates to the application of the phrase "by reason of," calls for an evaluation of the activities of *all* of the alleged conspirators in the aggregate in relation to the harm sustained by plaintiff as a part of a broader inquiry into the plaintiff's standing under RICO §1964(c).

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[3] The "causal connection" referred to in Question No. 2 relates to the nexus between the conduct of a single individual and the conduct of other individuals, to evaluate whether the individuals should be treated as co-conspirators.

Under RICO, the concept of proximate cause is inexorably interwoven with the concept of standing. "[T]he plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation. . . . [A]ny recoverable damages occurring by reason of a violation of §1962(c) will flow from the commission of the predicate acts." *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 496 (1985). A question involving civil RICO standing necessarily involves inquiry concerning the "by reason of" requirement.

SIPC argues that there is a question of fact as to whether causation exists which is sufficient for SIPC to survive the standing inquiry. (SIPC Brief, pp. 34-35). The District Court found that there may be a question of fact concerning whether SIPC's injuries would not have been caused "but for" the actions of defendants (Cert. Petition, p. 45(a) (Finding 8).[4] The possible existence of "but for"

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[4] To describe the Finding in a manner so favorable to SIPC involves grammatical license and resolution of all doubts in favor of SIPC for purposes of argument. Read literally and standing alone, the Finding says the opposite, that the alleged predicate acts "did not cause the injuries of [SIPC]." It is only if Finding 8 is considered to be included within the introduction to seven previous findings, ("although there is a genuine dispute regarding material facts with respect to the following issues") that Finding 8 in this context would mean the reverse of what it means standing alone. In view of the ruling by the District Court granting summary judgment to Holmes and the other related findings, (Cert. Petition, p. 38a, Finding 6, p. 39a, Finding 23, p. 46a) the position is stronger that Finding 8 should be read standing alone and not included within the questions of fact covered by the introduction to Findings 1-7.

causation, or causation in fact, however, does not end the inquiry into the causation element of RICO standing. To establish RICO standing, there must be both "but for" or factual causation (a broader scope of causation) and legal proximate causation (causation after applying policies of the law to the broad factual causal connection). See *Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 23 (2nd Cir. 1991); *O'Malley v. O'Neill*, 882 F.2d 1557, 1561 (11th Cir. 1989), *cert. denied*, 496 U.S. ___, 110 L.Ed. 2d 641 (1990); *Ocean Energy II, Inc. v. Alexander & Alexander*, 868 F.2d 740, at 747-748 (5th Cir. 1989); *Zervas v. Faulkner*, 861 F.2d 823, 834 (5th Cir. 1988).

Under securities laws, loss causation, (which is the equivalent of "proximate cause" under RICO when the "racketeering activity" consists of "fraud and the sale of securities") is not established when the plaintiff is neither a purchaser nor seller of securities. There is no basis upon which SIPC can satisfy the proximate cause requirement in the context of the RICO standing inquiry. This conclusion is readily confirmed upon an examination of SIPC's Complaint, which reveals: (1) that SIPC was neither a purchaser nor seller of the allegedly manipulated securities, and (2) the convoluted, speculative and unforeseeable series of conditions which resulted in SIPC incurring the expenses sought to be recovered. (*See* Joint Appendix, pp. 21-29, SIPC Complaint, para. 3-4). Even if there may be questions of fact regarding "but for" causation, application as a matter of policy of the holding in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), that a person who is neither a purchaser nor seller of securities has no standing to sue for fraud in the sale of securities, results in the conclusion that here there is no legal proximate cause.

III.

IT IS HOLMES, NOT SIPC, THAT IS FAITHFUL TO THE EXPRESS LANGUAGE OF RICO.

SIPC claims that if Holmes' view of standing were adopted, in effect, words would have to be added to RICO §1964(c) which are not already expressly there, to provide that a non-purchaser or non-seller does not have standing. (SIPC Brief, p. 19). In fact, it is not necessary to add any words to RICO §1964(c) to reach the conclusion Holmes advocates. One need only apply the existing language including the "injured in his business or property" and "by reason of" provisions. Applying these terms leads to the conclusion that SIPC does not have standing to sue.

Indeed, it is SIPC that seeks to depart from the express statutory language. To reach SIPC's conclusion, that the only prerequisite to standing is that the plaintiff be "any person," one must read out of the statute and ignore the express phrases that a person be "injured in his business or property" and that the injury be "by reason of" the alleged racketeering activity. SIPC would construe §1964(c) by separating the "victim," "injury," "cause," "wrong," and "remedy," implying that it is sufficient to achieve standing for SIPC to demonstrate that it is a "victim," or any "person." (SIPC Brief, pp. 3, 14, 18). SIPC argues as much when it states, "[s]ince the civil claim for relief under RICO is express, additional standing limitations on 'victim' are improper." (SIPC Brief, p. 19). SIPC even states, "RICO's civil remedy section unambiguously confers standing on all entities who are capable of holding a legal or beneficial interest in property." (SIPC Brief, p. 3).

The flaw in this interpretation is that it means that any "person" could acquire civil RICO standing even if the person were not injured in his business or property or even if the injury were not caused "by reason of" the racketeering activity. That is plainly not the statute nor the law. Even SIPC is forced to acknowledge that standing requires something more than merely being "a person," when it states that "the plaintiff only has standing if . . . *he has been injured in his business or property by the conduct constituting the violation.* . . . " (SIPC Brief, p. 19 *citing Sedima*, at 496) (emphasis added); *see also Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 23 (2nd Cir. 1990) (" . . . [I]n order to have standing [under §1964(c)] a plaintiff must show: (1) a violation of §1962; (2) injury to business and property; and (3) causation of the injury by the violation.")

IV.

THE LEGISLATIVE HISTORY OF RICO PROFFERED BY SIPC IS NOT INSTRUCTIVE ON THE QUESTION BEFORE THIS COURT.

SIPC examines the legislative history of RICO at length to conclude that "special judicial standing limitations" should not be read into RICO. (SIPC Brief, pp. 26-33). SIPC's argument is not persuasive because Holmes is not asking that any "special" limitation be read into RICO. The application of the purchaser/seller requirement is implicit in the express "injury" and "by reason of" language of RICO, and the statute should be applied in accordance with its plain meaning. Nowhere in the legislative history of RICO cited by SIPC is there

evidence that the question now before this Court was considered by Congress.

No inference can be made for treatment of securities law standing concepts under RICO from the relationship between RICO and the antitrust laws. The relationship between RICO and the antitrust laws is ambiguous at best. SIPC argues that unspecified "complexities" and "judicially created standing limitations" in antitrust standing concepts were decried by those considering RICO (SIPC Brief, pp. 20, 28-30), and RICO was enacted "outside of the anti-trust statutes." (SIPC Brief, p. 20). Nevertheless, RICO §1964(c) was patterned in relevant part verbatim after Section 4 of the Clayton Act, 15 U.S.C. §15.[5]

Further, "fraud in the sale of securities," which has its own historical civil standing requirement, is an act of "racketeering activity." There is no comparable act of "racketeering activity" for a "violation of the antitrust law." SIPC's argument, that since complex standing requirements under antitrust laws were rejected in developing RICO, standing requirements under securities laws should also be disregarded, is not persuasive. Complexities of standing under antitrust law, which may have been eschewed by Congress, such as the "target area

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[5] The Clayton Act, §4, 15 U.S.C. §15, provides, "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws" may sue. RICO at §1964(c) provides "any person injured in his business or property by reason of a violation of Section 1962 of this Chapter" may sue. See also SIPC Brief, p. 16, acknowledging that RICO's civil provisions create a private enforcement mechanism, "[l]ike the antitrust statutes."

approach,"[6] the "factual matrix test,"[7] the "balancing test,[8] and the "zone of interest,"[9] have no bearing in the securities law context and are not relied upon by Holmes. The rejection of complex antitrust standing limitations does not mean that RICO is entirely without its own limitations on standing.

The existence of an alleged post-RICO legislative effort to insert a purchaser/seller limitation by amendment to RICO (SIPC Brief, p. 32) has no bearing on the question before this Court. Post-legislative developments are a "hazardous" basis for divining legislative intent, and "must be weighed with extreme care," even if they "should not be rejected out of hand." *Andrus v. Shell Oil Co.*, 446 U.S. 657, 666 n. 8 (1980). It appears, for example, that the "major effort" to "insert a purchaser-seller limitation," identified by SIPC as a basis to infer that RICO does not presently contain a purchaser/seller requirement, did not directly address the purchaser/seller question, the considerations noted in *Blue Chip Stamps*, and standing. Instead, the measure referred to, H.R. 2983, generally addressed the availability of treble damages under RICO for specified "types of behavior," already covered by securities laws.[10] No significance for

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[6] *Karseal Corp. v. Richfield Oil Corp.*, 221 F.2d 358, 363 (9th Cir. 1955)

[7] *Cromar Co. v. Nuclear Materials & Equipment Corp.*, 543 F.2d 501, 506 (3rd Cir. 1976).

[8] *Bravman v. Basset Furniture Indus., Inc.*, 552 F.2d 90, 99 (3rd Cir. 1977).

[9] *Malamud v. Sinclair Oil Corp.*, 521 F.2d 1142, 1151 (6th Cir. 1975).

[10] *See generally*, 133 Cong. Rec. H8835-42 (daily ed. Oct. 20, 1987) (Statement of Rep. John Conyers).

Congressional intent regarding standing would follow from the non-adoption of proposed reform measures. As hazardous a basis for divining intent as is adoption, legislative non-passage is an even more hazardous ground on which to construct Congressional meaning.[11]

V.

SIPC IS ENTITLED TO NO SPECIAL STATUS IN EVALUATING ITS STANDING UNDER RICO.

The salutary purposes of the "private attorney general" concept in RICO civil actions adhere to all civil RICO plaintiffs, including SIPC. SIPC, however, is not entitled to more.

SIPC commences this action under the civil remedy section of RICO and cites RICO §1964(c) in its complaint as the provision upon which it relies. (Joint Appendix, p. 56, SIPC Complaint, par. 253.) SIPC's beliefs that its objectives are laudable (SIPC Brief, pp. 4-7, 47-50) does not

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[11] The opposition by Representative Conyers to H.R. 2983, the proposed amendment to RICO, was broadly based. Although Representative Conyers did focus on the purchaser/seller issue, there is no basis to infer from his statement that RICO does not presently contain a purchaser/seller requirement. Moreover, it is not at all clear that those who wished to reform RICO felt that RICO did not contain a purchaser/seller limitation. The Senate Report on S.438, the Senate Bill, which proposed to amend RICO in 1989, observed that "some courts have . . . held under existing law" that only a purchaser or seller of securities may sue civilly under RICO for fraud in the sale of securities. S. Rep. No. 269, 101st Cong., 2d Sess. 20 (1990) (reporting S. 438). S.438 would have drastically curtailed RICO by de-trebling damage awards for most private suits, including many consumer suits, and purchaser/seller standing limitations, although discussed, were not a focal point of contention. *See generally ibid.*

change SIPC from a "private attorney general" into the actual Attorney General, does not change this private civil action into a government-commenced criminal action (which would not be subject to the civil standing requirements of §1964(c)) and does not excuse noncompliance with the requirements for standing under §1964(c) pertaining to all civil RICO litigants. SIPC has not established that the legislative history of RICO, SIPA or any other statute confers upon SIPC an exemption from the standing requirements applicable to all other plaintiffs under §1964(c).

The Resolution Trust Corporation ("RTC") and the Federal Deposit Insurance Corporation ("FDIC"), which have succeeded the now defunct FSLIC, whose status SIPC seeks to emulate (SIPC Brief, pp. 48-49, n. 253), are authorized by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") at §212, 12 U.S.C. §1821(d)(2)(A)(i) to acquire "all rights, titles, powers and privileges of the insured depository institution" to which the RTC or FDIC is a successor in interest. Under FIRREA, the RTC and FDIC have the power to sue on behalf of the institution under their receivership, and it was in that capacity that the federal agencies brought RICO claims in the cases cited by SIPC. SIPC, however, acts under no similar authorization here. SIPC is neither a receiver nor a successor in interest to the defunct brokerage firms and does not have statutory powers parallel to those of the RTC or FDIC. Further, SIPC is suing here to recover advances made to customers of the defunct brokerage firms (*see* Joint Appendix, p. 56-57, SIPC Complaint, Prayer for Relief, A(1) and (2)). The RTC, FDIC

and FSLIC, in the cases cited by SIPC, were seeking different relief, to recover damages sustained by the defunct entities on behalf of the entity.

SIPC's apparent claim of special standing status because it "vindicates public interests" (SIPC Brief, pp. 22, 49) is not pertinent to the issue at hand. SIPC is not "an agency or establishment of the United States Government" (SIPA, 15 U.S.C. §78ccc(a)(1)(A)) and SIPC is not funded by the government from public taxation revenues. SIPC obtains revenue from assessments imposed privately against securities broker-dealers that are members of SIPC. SIPC, 15 U.S.C. §78ddd(C).

The Securities and Exchange Commission ("SEC"), unlike SIPC, is a government agency and would be entitled to institute criminal RICO proceedings free of civil RICO standing requirements. The SEC, notwithstanding participation as an amicus with SIPC at the Ninth Circuit below, is conspicuously absent as an amicus for SIPC on the issue before this Court.[12]

SIPC does not acquire standing here by virtue of its laudable objectives, statutory hybrid status or subrogation. As a "private attorney general," SIPC is entitled to

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[12] Before the Ninth Circuit, the SEC shared SIPC's views on the question of conspiracy, Question 2 in the Cert. Petition, and filed an amicus brief supporting SIPC. The SEC may well not share SIPC's view on Question 1 of the Cert. Petition which is here at issue. The SEC has been an active advocate to reform RICO to conform it specifically to the implied and express remedies available under federal securities laws. *See Hearings on H.R. 1046 Before the Subcommittee on Crime of the House Judiciary Committee*, 101st Cong. 1 Sess., 513-90 (1989) (Statement of SEC General Counsel, Daniel C. Goelzer).

no more than any other civil RICO plaintiff with respect to standing requirements.

VI.

THE MANDATE THAT RICO BE LIBERALLY CONSTRUED DOES NOT RESOLVE THE QUESTION BEFORE THIS COURT.

SIPC emphasizes Congress' directive that RICO be liberally construed to effectuate its remedial purposes. (SIPC Brief, pp. 10, 20). Acknowledging that mandate does not help resolve the question before this Court. Since the words "injured in his business or property" and "by reason of" are contained in the express language of RICO, they too are a subject of the mandate that RICO be construed broadly.

Another view of the mandate of broad construction is that the object of the mandate is to broaden the remedy of the statute. (SIPC Brief, p. 20). Since the "remedy" is not here at issue, but rather another concept (in SIPC's view, the "victim" or "cause" or "injury"), then the mandate to construe RICO broadly does not apply.

VII.

STATUTORY SILENCE, IF ANY, IS NOT A SUFFICIENT REASON FOR AN INTERPRETATION ADVERSE TO HOLMES.

SIPC suggests that RICO is "silent" on the issue before this Court and the Court should not supply extraneous language to fill the silence. (SIPC Brief, p. 20).

The statute is not silent. It expressly contains the phrases "injured in his business or property" and "by

reason of" which are the bases from which a resolution of the standing question should be determined. SIPC, however, argues that because RICO does not expressly incorporate by reference and identify §10(b) of the Exchange Act and Rule 10b-5, RICO does not incorporate the purchaser/seller requirement of standing. (SIPC Brief, pp. 20-22). SIPC claims that RICO incorporates §32(a) of the Exchange Act, 15 U.S.C. §78ff, and that §32(a), unlike §10(b), contains no purchaser/seller standing limitations. (SIPC Brief, p. 22). The principle difficulty with this argument is that it is not borne out by the RICO statute. RICO does not mention §32(a) of the Exchange Act by number, title or description when identifying the predicate act of racketeering activity as "fraud in the sale of securities." Yet in §1961(1), RICO does identify 36 other statutes by direct citation to the number and title of the relevant provision when listing the predicate acts of racketeering activity, which is a strong indication that RICO did not intend to incorporate §32(a).

The introductory phrase "an offense involving" fraud in the sale of securities does not change the result. Section 32 renders criminal any wilful violation of any portion of the Exchange Act. Courts have held that not every violation of the Exchange Act (e.g., a violation of the reporting or proxy rules) constitutes racketeering activity. (*See, e.g., First Pacific Bancorp, Inc. v. Bro*, 847 F.2d 542 (9th Cir. 1988)). Only a violation of securities law which involves fraud in the sale of securities will suffice as an act of racketeering activity. (*See* Holmes Brief, pp. 23-26 and cases cited). The obvious conclusion is that §32, and with it securities fraud violations that do not involve a purchaser or seller, were *not* incorporated as predicate acts of RICO. When SIPC states that Exchange Act §32 (which

involves no purchaser/seller requirement) is incorporated as a RICO predicate offense and not §10(b) (which does involve a purchase/seller requirement), SIPC is engaging in statutory wish fulfillment rather than statutory construction.

SIPC's further arguments that had Congress wanted to impose a standing limitation on RICO, it had only to add appropriate language (SIPC Brief, p. 22) and that Congress was aware of the overlap between RICO and the securities statutes (SIPC Brief, p. 22) are similarly unavailing. A statute is not required to identify expressly and resolve on its face the infinite variety of facts and circumstances to which the statute may apply. *Comm'n on Indep. Colleges & Universities v. N.Y. Temporary State Comm'n on Regulation of Lobbying*, 534 F. Supp. 489, 502 (N.D.N.Y. 1982); *Zenith Radio Corp. v. Matsushita Elec. Indus. Co., Ltd.*, 402 F. Supp. 251, 254-255 (E.D. Pa. 1975). That is a job for courts, on a case by case basis. The statute may well and properly be silent on a specific application of its general concepts. Such silence does not operate to countervail or read out of existence the general principles and language of the statute.

Equally, there is no reason to infer from statutory silence any intent to overrule *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) or settled precedents of securities law. (*See* Holmes Brief, pp. 28-33).

VIII.

SIPC HAS FAILED TO ESTABLISH THAT HOLMES' POLICY ARGUMENTS ARE WITHOUT MERIT.

Although SIPC entitles its argument *"Holmes'* Policy Arguments Are a Matter for Congress and are Meritless"

(SIPC Brief, p. 39, emphasis added), in the main, SIPC attributes "arguments" to Holmes that were not made by Holmes and instead have apparently been made from time to time by unnamed "proponents of reform" (SIPC Brief, p. 41). These "policy" arguments have been created and rebutted in law review articles and are apparently re-created here.[13] They are of interest but, not having been raised or adopted by Holmes, have little bearing on this Court's decision.[14]

The policy considerations which were identified by Holmes, that of avoiding suspicious claims (*see* Holmes Brief, pp. 34-35) and avoiding an inadvertent and inappropriate overruling of *Blue Chip Stamps* (Holmes Brief, pp. 28-33), are not addressed by SIPC except in so far as

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[13] *See* Blakey & Perry, *An Analysis of the Myths that Bolster Efforts to Rewrite RICO and the Various Proposals for Reform*, 43 Vand. L. Rev. 851 (1990); Blakey, *Foreword: Debunking RICO's Myriad Myths*, 64 St. John's L. Rev. 701 (1990).

[14] SIPC's dismissal of concerns about RICO's broad application, which have been expressed in various academic, judicial, business and legislative circles, is facile and gratuitous. An expansive use of RICO has raised legitimate questions as to whether Congress intended the statute to be used that way. For example, in reporting on one attempt to bring "clarity" and "specificity" to RICO, members of the Senate Committee on the Judiciary stated that "[t]he use of Civil RICO in [a variety of] disputes is not what Congress had in mind when it was debating RICO as a tool to fight organized crime." S. Rep. No. 269, 101st Cong., 2d Sess. 20 (1990) (reporting S. 438).

Moreover, one of the senators who was an original sponsor and legislative promoter of RICO, Senator Roman L. Hruska, has recently indicated that, personally, he believes RICO to have been misused in a manner in which he never intended when he introduced the statute in Congress. *See Oversight on Civil RICO Suits: Hearing before the Sen. Comm. on the Judiciary*, 99th Cong., 1st Sess. (1985) at p. 4, 9.

SIPC apparently believes that it is exempt from *Blue Chip's* application which "sadly . . . stands as an unwarranted obstacle to SIPC's ability to . . . preserve and restore its . . . trust fund." (SIPC Brief, p. 49, n. 252). SIPC believes that it "should be allowed . . . to bring wrongdoers to account . . . without regard to *Blue Chip*." (*Id.*). SIPC goes too far when it seeks to exempt itself from provisions of the Exchange Act reflected in settled judicial decisions. The statutory mandate of SIPC is subject to the Exchange Act, which applies to SIPA "as if [SIPA] constituted an amendment to, and was included as a section of, [the Exchange Act]." SIPA, 15 U.S.C. §78bbb.

The "Litigation Floodgate Myth" was not advanced by Holmes, and where Holmes is cited as having adopted it (SIPC Brief, p. 41), Holmes expressed the view that relaxing standing requirements would unduly burden the judicial system when the questions raised by standing can best be resolved at the outset by the Court. Easing standing requirements would result in more harm than good and would itself be an invitation to fraud. (*See* Holmes Brief, p. 36). A compilation of the number of RICO complaints filed, validity of concern about court dockets and other such extraneous evidence, none of which is properly in the record before this Court, will not assist in resolving the question as to which certiorari has been granted.

Other "myths" identified and discussed by SIPC (SIPC Brief, p. 43-48) do not reflect concerns expressed by Holmes except with respect to the possibility of extortionate settlements. Holmes noted that the Court in *Blue Chip* stated that even a complaint, which by objective standards has very little chance of success at trial, has a

disproportionate settlement value so long as the plaintiff can prevent the suit from being dismissed by motion. (Holmes Brief, p. 34). SIPC's sociological response includes speculation about the views of an unidentified "majority of seasoned litigators in the RICO area" (SIPC Brief, p. 44, n. 228) and speculation concerning what unspecified "plaintiffs" file "often" "today" to enhance settlement prospects (SIPC Brief, p. 44). This, too, does little to respond to the concerns expressed by the Court in *Blue Chip Stamps*.

IX.

THE STANDING REQUIREMENTS OF SECTION 1964(c) ALSO APPLY TO MAIL AND WIRE FRAUD.

There is no dispute among the parties that the question of standing, when mail and wire fraud are alleged as predicate acts of "racketeering activity" arising out of fraud in the sale of securities, is within the grant of certiorari. (SIPC Brief, p. 23, n. 91). SIPC argues that the "schemes to defraud" prohibited by the mail and wire fraud statutes are broad and extend to a great variety of transactions (SIPC Brief, pp. 23-24), and neither the wire nor mail fraud statutory prohibitions are limited by a purchaser/seller standing requirement. (SIPC Brief, p. 25). Granting the validity of those observations, they have no bearing on the question before this Court. The requirements of §1964(c), establishing direct injury to business or property of the plaintiff and damage causation, remain as applicable when mail and wire fraud are alleged as the predicate acts of "racketeering activity" as when fraud in the sale of securities is the predicate act. A person who was neither a purchaser nor seller of securities cannot have been directly injured in his business or property by reason of the fraud in the sale of securities

that constituted the mail and wire fraud. (*See* Holmes Brief, pp. 41-44).

CONCLUSION

Even assuming that treble damage suits may be the backbone of private enforcement, that there is much fraud in the world that merits punishment, that "private attorneys' general" play an important role in RICO enforcement, and that SIPC is a worthwhile agency with laudable objectives, this Court should not reach the conclusion that the plain, express standing requirements contained in §1964(c) should be ignored at SIPC's request. SIPC has simply not been injured in its business or property by reason of any fraud in the sale of securities.

Although SIPC has expressed a desire to deal with the larger issues in society and enhance its role as a self-styled prosecutor of perceived wrongs, those matters are not at issue here and do not alter the standing requirements which SIPC must satisfy in order to proceed. Accordingly, the decision of the Ninth Circuit should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR., PETITIONER

v.

SECURITIES INVESTOR PROTECTION CORP., ET AL.,
RESPONDENTS

**On Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit**

BRIEF OF ARTHUR ANDERSEN & CO., COOPERS & LYBRAND, DELOITTE & TOUCHE, ERNST & YOUNG, KPMG PEAT MARWICK, AND PRICE WATERHOUSE AS AMICI CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether an entity that was neither a purchaser nor a seller of securities in the transaction at issue, and for that reason could not assert a claim for damages under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder (17 C.F.R. § 240.10b-5), may nonetheless maintain a damages action under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1964(c), predicated on alleged violations of Section 10(b).

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In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-727

ROBERT G. HOLMES, JR., PETITIONER

v.

SECURITIES INVESTOR PROTECTION CORP., ET AL.,
RESPONDENTS

**On Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit**

**BRIEF OF ARTHUR ANDERSEN & CO.,
COOPERS & LYBRAND, DELOITTE & TOUCHE,
ERNST & YOUNG, KPMG PEAT MARWICK,
AND PRICE WATERHOUSE AS AMICI CURIAE
IN SUPPORT OF PETITIONER**

INTEREST OF THE AMICI CURIAE

The amici curiae are professional firms engaged in the practice of accountancy. They are the six largest firms of independent accountants in the United States, reporting, collectively, on the financial statements of more than 90 percent of those companies whose securities are publicly traded in the United States.

Congress long ago concluded that independent public accountants perform an important public service. The Securities Act of 1933 and the Securities Exchange Act of 1934 require all public companies whose securities are registered with the Securities and Exchange Commission

to have their financial statements examined by independent accountants. See 15 U.S.C. § 77aa (Schedule A) (25)-(27); *id.* 78*l*(b)(1)(J)-(K).

Amici have in recent years repeatedly been targeted by plaintiffs as a "deep pocket" in various types of litigation. Specifically, amici have witnessed a dramatic increase in the number of state and federal law claims filed against them ostensibly based on their rendition of professional services. Four times as many such claims were made against amici in 1990 as were made in 1981. Amici are concerned that this increase in exposure to the risks of litigation may cause them difficulty in attracting and retaining the most qualified professional personnel. See Note, *Detecting and Preventing Financial Statement Fraud: The Roles of the Reporting Company and the Independent Auditor*, 5 Yale L. & Pol'y Rev. 514, 526 (1987) (accounting profession is "finding it increasingly difficult to attract quality personnel").

The lawsuits filed against amici typically include claims under the federal securities laws, including Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, and—with increasing frequency—claims under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1964(c). See Mathews, *Shifting the Burden of Losses in the Securities Markets: The Role of Civil RICO in Securities Litigation*, 65 Notre Dame L. Rev. 896, 897-898 (1990) ("Civil RICO has become one of the statutes of choice for pursuing an alternative route to recovery in federal securities litigation, as plaintiffs seek to find a 'deep pocket' defendant to pay their damage claims") (footnotes omitted). Even when meritless, a RICO claim, which carries liability for treble damages and attorneys' fees, can skew litigation strategies: "the defendant, facing a tremendous financial exposure in addition to the threat of being labeled a 'racketeer' will have a strong interest in settling the dispute." *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 504 (1985) (Marshall, J., dissenting).

Because of the substantial impact of even the threat of treble damages liability on a profession whose activities Congress has found to be in the public interest, amici believe that their views on the scope of the RICO damages remedy may be of assistance to the Court's consideration of this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

There can be no doubt that "in its private civil version, [the Racketeer Influenced and Corrupt Organizations Act (RICO)] is evolving into something quite different from the original conception of its enactors." *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 500 (1985). See also *H. J. Inc.* v. *Northwestern Bell Telephone Co.*, 492 U.S. 229, 255 (1989) (Scalia, J., concurring in the judgment) ("RICO has 'quite simply revolutionize[d] private litigation' and 'validate[d] the federalization of broad areas of state common law of frauds'") (quoting *Sedima*, 473 U.S. at 501 (Marshall, J., dissenting)); Rehnquist, *Remarks of the Chief Justice on Diversity Jurisdiction and Civil RICO*, 21 St. Mary's L.J. 5, 9 (1989). RICO's extremely broad reach, its harsh penalties—treble damages, attorneys' fees, and stigmatization of the defendant as a "racketeer"—and the fact that the statute confers federal court jurisdiction make RICO claims especially attractive to plaintiffs. The consequent widespread invocation of RICO in ordinary commercial disputes—situations far from the organized crime context that was the focus of Congress's concern—has received considerable criticism. See, *e.g.*, *Sedima*, 473 U.S. at 501-507 (Marshall, J., dissenting); *id.* at 529-530 (Powell, J., dissenting); *RICO Reform Legislation: Hearings Before the Subcomm. on Criminal Justice of the House Comm. on the Judiciary*, 99th Cong., 1st & 2d Sess. 3-5, 365-366, 527-528, 778-782, 790-796, 834-841, 1223, 1230-1232 (1985-1986)

(testimony of various witnesses); Mathews, *Shifting the Burden of Losses in the Securities Markets: The Role of Civil RICO in Securities Litigation*, 65 Notre Dame L. Rev. 896, 899-900 & nn. 20-21 (1990) (collecting authorities).

This Court determined in *Sedima* that these unanticipated applications of RICO did not justify curtailing the statute's scope by reading into the private damages remedy a requirement that the plaintiff prove, for example, that the defendant had been criminally convicted for the conduct underlying the civil action. The question in this case, however, is not whether RICO's expansive civil liability should be curbed through such requirements. The question here is whether RICO damages actions should be governed by the conventional rules frequently utilized by this Court to determine the appropriate scope of a cause of action. Given RICO's broad reach, it is inconceivable that Congress would have intended to exempt the RICO damages action from the generally-applicable principles governing damages liability under federal law. These principles are dispositive here, establishing beyond any doubt that respondent Securities Investor Protection Corporation (SIPC) may not maintain a RICO civil action predicated on violations of the securities laws where SIPC was neither a purchaser nor a seller of securities.

SIPC's complaint asserted claims against petitioner under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, and under the RICO statute, 18 U.S.C. § 1964(c). The "pattern of racketeering activity" relied upon by SIPC in support of its RICO claim included the alleged Section 10(b) violations. It is undisputed that in order to maintain a claim under Section 10(b), a plaintiff must have either purchased or sold the securities at issue. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). The district court held that SIPC could not

recover under Section 10(b) because it was not a purchaser or a seller. Pet. App. 29a-30a. For the same reason, the court concluded that SIPC could not rely on the alleged Section 10(b) violations as predicates for its RICO claim. *Id.* at 45a. SIPC appealed only with respect to the RICO claim and the court of appeals reversed, holding that a plaintiff who is barred from asserting a damages claim under Section 10(b) may nonetheless rely on Section 10(b) indirectly—and seek treble damages and attorneys' fees—by asserting a RICO action predicated on violations of Section 10(b). Pet. App. 10a-14a.

Nothing in the language or legislative history of RICO justifies that bizzare result. "Congress * * * did not write the RICO statute in a vacuum. It enacted this legislation * * * against the backdrop of almost forty years of federal securities law." *International Data Bank* v. *Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987). A key element of that background is the rule, long adhered to by the federal courts and reaffirmed in *Blue Chip Stamps*, that only purchasers and sellers of securities may recover damages under Section 10(b). "If Congress had intended the dramatic result of overturning this consensus, it surely would have done so in a more explicit way." *International Data Bank*, 812 F.2d at 152. The *Blue Chip Stamps* rule rests in large part on the weighty policy against speculative damages claims. It is inconceivable that Congress would have intended to eliminate that rule in a context in which the danger of such speculative claims would be *increased* by the prospect of recovering treble damages and attorneys' fees.

The language and legislative history of the RICO statute—together with general principles of statutory interpretation—establish beyond any doubt that Congress did not intend to expand the class of persons entitled to recover damages for violations of Section 10(b). Congress intended to "pattern RICO's civil enforcement provision on the Clayton Act." *Agency Holding Corp.* v.

Malley-Duff & Associates, Inc., 483 U.S. 143, 152 (1987). Interpreting the Clayton Act, which states that "[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws" may recover treble damages and costs, including attorneys' fees (15 U.S.C. § 15), this Court has held that the right of a plaintiff to maintain an antitrust claim depends upon "the plaintiff's harm, the alleged wrongdoing by the defendant, and the relationship between them." *Associated General Contractors of California, Inc.* v. *California State Council of Carpenters*, 459 U.S. 519, 535 (1983) (footnote omitted). In determining whether the relationship between the harm and the alleged wrongdoing is appropriate for the imposition of damages liability, a court must consider the nature of the plaintiff's injury, the directness or indirectness of that injury, whether the claim rests on a speculative measure of harm, and whether the lawsuit would require complex damages proceedings.

The provision of RICO authorizing civil damages actions, which provides in language essentially identical to the Clayton Act that "[a]ny person injured in his business or property by reason of a violation of [18 U.S.C. §] 1962" may maintain an action for treble damages and costs, including attorneys' fees, mandates the same type of inquiry. When a plaintiff asserts a RICO claim under Section 1962(c), alleging that the defendant conducted the affairs of an "enterprise" through "a pattern of racketeering activity," the plaintiff's injury must bear an appropriate relationship to the particular type of "racketeering activity" alleged in the complaint. The court must apply the *Associated General Contractors* factors to determine whether the imposition of damages liability is proper.

This determination is easy when the "racketeering activity" relied on by the plaintiff consists of violations of Section 10(b), because this Court answered the very

same question in *Blue Chip Stamps*. The Court's analysis in *Blue Chip Stamps* sought to determine whether an injury incurred by persons who neither bought nor sold securities is sufficiently related to a violation of Section 10(b) to give rise to a right to recover damages. The Court's conclusion that a nonpurchaser-nonseller may not recover in an action implied under Section 10(b) should also apply when a plaintiff relies on that provision indirectly in the context of a RICO claim. The factors relied on in *Blue Chip Stamps*—that Congress's concern in enacting Section 10(b) extended only to injured purchasers and sellers and that permitting recovery by nonpurchasers and nonsellers would encourage speculative (and even fraudulent) damages claims—apply with equal force here.

This Court has construed other broad federal remedies —such as 42 U.S.C. § 1983—to incorporate well-settled limits on damages liability, such as common law immunity rules. In view of the integral position of the purchaser-seller rule in securities law, the same approach is appropriate in determining the class of plaintiffs entitled to recover damages under RICO for violations of Section 10(b).

ARGUMENT

THE SECURITIES INVESTOR PROTECTION CORPORATION MAY NOT MAINTAIN A RICO CLAIM PREDICATED ON SECURITIES FRAUD

The Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1962, provides that "[i]t shall be unlawful" to engage in certain "prohibited activities" involving "a pattern of racketeering activity." For example, "any person employed by or associated with" an enterprise engaged in interstate or foreign commerce may not "conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity." *Id.* § 1962(c). Other conduct prohibited by Section 1962 includes "us[ing] or invest[ing]"

any "income derived, directly or indirectly, from a pattern of racketeering activity" in connection with an enterprise engaged in interstate or foreign commerce. *Id.* § 1962(a). See also *id.* § 1962(b) (prohibiting use of "a pattern of racketeering activity" to "acquire or maintain, directly or indirectly, any interest in or control of any enterprise" engaged in interstate or foreign commerce); *id.* § 1962(d) (conspiring to engage in any of the foregoing activities).

The statute defines "racketeering activity" to encompass "any act or threat involving" certain specified state-law crimes, an "act" indictable under specified federal statutes, and certain federal "offenses." 18 U.S.C. § 1961(1). This Court addressed the requirement that there be a "pattern" of such activity in its decision in *H.J. Inc.* v. *Northwestern Bell Telephone Co.*, 492 U.S. 229 (1989).

Section 1964(c) of RICO states that "[a]ny person injured in his business or property by reason of a violation of section 1962" may maintain an action in federal court for treble damages and costs, including attorneys' fees. The question in this case is whether the Securities Investor Protection Corporation (SIPC) was "injured in its business or property by reason of" a Section 1962 violation predicated on violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. There is no dispute that SIPC could not maintain a damages action under Section 10(b) and Rule 10b-5. It neither purchased nor sold the securities at issue and therefore did not incur an injury compensable under that statute. See *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). We submit that SIPC may not invoke Section 10(b) indirectly, by asserting a RICO claim predicated on Section 10(b) violations, for essentially the same reason—as a nonpurchaser and nonseller, SIPC cannot satisfy the applicable RICO injury requirement.

This Court first considered the meaning of the phrase "injured in its business or property by reason of a violation of section 1962" in *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S 479 (1985) It concluded that Section 1964(c) neither restricts civil liability to defendants who have been convicted criminally of a predicate offense or a RICO violation (*id.* at 488-493) nor imposes a "distinct 'racketeering injury' requirement" that plaintiffs must satisfy in order to recover damages (*id.* at 495). Contrary to respondents' apparent view (Br. in Opp. 13-14), however, *Sedima*'s rejection of these particular preconditions to civil liability does not mean that Section 1964(c) imposes *no* limits on the class of plaintiffs eligible to institute civil RICO actions.

Indeed, *Sedima* itself recognized that a RICO plaintiff may recover damages only if there is an appropriate relationship between the defendant's conduct and the plaintiff's injury. Thus, the Court stated that "the plaintiff only has standing if, and can only recover to the extext that, he has been injured in his business or property by the conduct constituting the violation." 473 U.S. at 496. See also *id.* at 495 (if the defendant's "racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim under § 1964(c)") & 497 (discussing "recoverable damages occurring by reason of a violation of § 1962(c)"). This case requires the Court to identify the considerations relevant in determining whether the relationship between the defendant's alleged conduct and the plaintiff's alleged injury permits the recovery of damages under RICO.

A. A Plaintiff Is "Injured In His Business Or Property By Reason Of" A Section 1962 Violation Only When There Is An Appropriate Connection Between The Plaintiff's Particular Injury And The Alleged Statutory Violation.

The general principle that a defendant may not be held liable in damages for all direct and indirect injuries flowing from his conduct is well recognized in the law. See,

e.g., *Associated General Contractors of California, Inc.* v. *California State Council of Carpenters*, 459 U.S. 519 (1983); *Southern Pacific Co.* v. *Darnell-Taenzer Lumber Co.*, 245 U.S. 531, 533 (1918) (observing, in interpreting a statute, that "[t]he general tendency of the law, in regard to damages at least, is not to go beyond the first step"); *Ultramares Corp.* v. *Touche*, 255 N.Y. 170, 179-180, 174 N.E. 441, 444 (1931) (Cardozo, C.J.); *North Shore Gas Co.* v. *EPA*, No. 91-1077 (7th Cir. Apr. 25, 1991), slip op. 3-5 (Posner, J.); *Prosser and Keeton on The Law of Torts* § 36, at 224-225 (5th ed. 1984). The question in this case, therefore, is not whether this principle applies to RICO civil actions—there is no evidence whatever that Congress intended to exempt the RICO civil action from legal rules generally applicable to damages claims—but rather how that principle should be given content in the RICO context. The obvious starting point for that inquiry is Section 4 of the Clayton Act, 15 U.S.C. § 15.

This Court repeatedly has recognized that Section 1964(c) "was patterned after the Clayton Act." *Agency Holding Corp.* v. *Malley-Duff & Associates, Inc.*, 483 U.S. 143, 150 (1987). See also *Sedima*, 473 U.S. at 487, 489. In language virtually identical to that of Section 1964(c), the Clayton Act provides that "[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws" may recover treble damages, costs, and attorneys' fees. 15 U.S.C. § 15(a). "The close similarity of the two provisions is no accident. The 'clearest current' in the legislative history of RICO 'is the reliance on the Clayton Act model.'" *Agency Holding Corp.*, 483 U.S. at 151 (quoting *Sedima*, 473 U.S. at 489). Thus, Representative Steiger, who proposed the inclusion of a private treble damages remedy in the statute, characterized his proposal as "similar to the private damage remedy found in the anti-trust laws." *Hearings on S. 30 and Related Proposals Before Subcomm. No. 5 of the House Comm. on the Judiciary*, 91st

Cong., 2d Sess. 520 (1970). Other legislators referred to "the antitrust remedy being adapted for use against organized criminality." 116 Cong. Rec. 35295 (1970) (remarks of Rep. Poff). See generally *Agency Holding Corp.*, 483 U.S. at 151-152.[1]

In view of "the clear legislative intent to pattern RICO's civil enforcement provision on the Clayton Act" (*Agency Holding Corp.*, 483 U.S. at 152), the decisions construing the scope of the damages remedy created by the Clayton Act provide the most appropriate guide for interpreting Section 1964(c)'s limitation of civil actions under RICO to plaintiffs "injured in [their] business or property by reason of" a Section 1962 violation. See, *e.g.*, *Oscar Mayer & Co.* v. *Evans*, 441 U.S. 750, 756 (1979) (where statutes share common language, common purpose, and where one was the model for the other, it is appropriate to look to prior statute in interpreting subsequently-enacted provision).

This Court's seminal decision interpreting the relevant language of the Clayton Act is *Associated General Contractors of California, Inc.* v. *California State Council of Carpenters*, *supra*. The Court observed at the outset of its analysis in that case that "[a] literal reading of the [Clayton Act] is broad enough to encompass every harm that can be attributed directly or indirectly to the consequences of an antitrust violation." 459 U.S. at 529. The Court concluded, however, that the question whether a

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[1] The statute's legislative history contains a number of other references establishing Congress's clear intent to model Section 1964(c) on the Clayton Act. See, *e.g.*, S. Rep. No. 91-617, 91st Cong., 1st Sess. 81 (1969) (antitrust laws "contain several useful and workable features which are appropriate" in the RICO setting); 116 Cong. Rec. 25190-25191 (1970) (remarks of Sen. McClellan) (civil RICO actions are modeled "upon the concept of Section 4 of the Clayton Act"); *id.* at 35201 (remarks of Rep. Poff); *id.* at 27739 (letter to House Judiciary Comm. from Rep. Steiger); *Hearings on S. 30 and Related Proposals Before Subcomm. No. 5 of the House Comm. on the Judiciary*, 91st Cong., 2d Sess. 543-544 (1970) (American Bar Association testimony).

particular plaintiff is entitled to recover treble damages under the antitrust laws "cannot be answered simply by reference to [the statute's] broad language." *Id.* at 535. "Instead, * * * th[at] question requires us to evaluate the plaintiff's harm, the alleged wrongdoing by the defendants, and the relationship between them." *Ibid.* (footnote omitted).

Analogizing the inquiry under the Clayton Act to "the struggle of common-law judges to articulate a precise definition of the concept of 'proximate cause,'" the Court stated that "[i]t is common ground that the judicial remedy cannot encompass every conceivable harm that can be traced to alleged wrongdoing. In both situations, the infinite variety of claims that may arise makes it virtually impossible to announce a black-letter rule that will dictate the result in every case." 459 U.S. at 536 (footnotes omitted). The Court therefore undertook to "identify factors that circumscribe and guide the exercise of judgment in deciding whether the law affords a remedy in specific circumstances." *Id.* at 537.

First, the Court examined the "nature of the plaintiff's alleged injury" to determine whether it was "'of a type that Congress sought to redress in providing a private remedy for violations of the antitrust laws.'" 459 U.S. at 538 (citation omitted). The plaintiff's alleged injury must stem from "an anti-competitive aspect of the practice under scrutiny" in order to satisfy this test. See, *e.g.*, *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 110 S. Ct. 1884, 1889 (1990)

Second, the Court assessed "the directness or indirectness of the asserted injury." *Associated General Contractors*, 459 U.S. at 540. "The existence of an identifiable class of persons whose self-interest would normally motivate them to vindicate the public interest in antitrust enforcement diminishes the justification for allowing a more remote party * * * to perform the office of a private attorney general" because it "is not likely to

leave a significant antitrust violation undetected or unremedied." *Id.* at 542.

Third, the Court "'consider[ed] whether a claim rests at bottom on some abstract conception or speculative measure of harm.'" *Id.* at 543 (quoting *Blue Shield of Virginia* v. *McCready*, 457 U.S. 465, 475 n.11 (1982)). If the damages claim rests on allegations that are speculative, the claim may not be maintained. 459 U.S. at 542.

Fourth, guided by "the strong interest * * * in keeping the scope of complex antitrust trials within judicially manageable limits," the Court evaluated "the risk of duplicate recoveries on the one hand, or the danger of complex apportionment of damages on the other." 459 U.S. at 543-544 (footnote omitted). If the lawsuit would result in complex damages proceedings, that fact weighs against permitting the plaintiff to proceed.

In view of the close relationship between Section 1964 (c) and the Clayton Act, the foregoing general principles should be applied in determining whether a plaintiff may maintain a RICO civil action under Section 1964(c).[2]

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[2] The Court's decision in *Tafflin* v. *Levitt*, 110 S. Ct. 792 (1990), supports this conclusion. Applying the "deeply rooted presumption in favor of concurrent state court jurisdiction" (*id.* at 795), the Court held that RICO claims may be brought in state court. It rejected the argument that because Section 1964(c) is modeled on the Clayton Act, RICO claims should be treated like antitrust claims, which may be brought only in federal court. *Tafflin* did not dispute the close relationship between RICO and the Clayton Act. The Court instead observed that in *Sedima* and *Agency Holding Corp.* it had "looked to the Clayton Act in interpreting RICO without the benefit of a background juridical presumption of the type present in this case." 110 S. Ct. at 797. The decision in *Tafflin* thus rested on the especially high standard that must be met in order to overcome the presumption favoring concurrent jurisdiction—that Congress "affirmatively or unmistakably intended jurisdiction to be exclusively federal." *Ibid.* In the present case, where the applicable "background juridical presumption" *favors* limitations on private damages remedies (see pages 15-16, *infra*), the Clayton Act analogy is especially appropriate.

We recognize that this Court concluded in *Sedima* that Section 1964(c) does not impose a "competitive injury" requirement (473 U.S. at 497 n.15), observing that "a previous proposal to add RICO-like provisions to the Sherman Act had come to grief in part precisely because it 'could create inappropriate and unnecessary obstacles in the way of . . . a private litigant [who] would have to contend with a body of precedent—appropriate in a purely antitrust context—setting strict requirements on questions such as "standing to sue" and "proximate cause"'" (*id.* at 498 (citation omitted)). But the fact that Congress did not intend the wholesale transfer to the RICO context of specific standing rules developed to govern antitrust actions—such as the competitive injury requirement—should not mean that all Clayton Act jurisprudence is irrelevant in interpreting Section 1964(c). The competitive injury requirement reflects the substantive focus of the antitrust laws. Because RICO is not directed solely against injuries to competition, an across-the-board competitive injury requirement would have been inconsistent with the substantive provisions of the statute.

The competitive injury rule is, however, just a particularized application of the general principle regarding the scope of damages liability, discussed above, that the Court has grounded in the Clayton Act's requirement that a plaintiff be "injured in his business or property by reason of anything forbidden in the antitrust laws." Nothing in this Court's decision in *Sedima* indicated that Congress intended to reject that more general principle along with the competitive injury requirement. Rather, in view of Congress's oft-expressed goal of creating a "'parallel private . . . remed[y]' to the Clayton Act" (*Agency Holding Corp.*, 483 U.S. at 152 (citation omitted)), that general legal principle should be applied—in light of the different substantive provisions of RICO—to develop a separate and distinct doctrine defining the class of plaintiffs entitled to maintain RICO civil actions.

Taking the opposite approach, and ignoring that principle, would frustrate Congress's clear intent that the RICO damages action mirror the antitrust remedy.[3]

Moreover, the approach under the Clayton Act fully accords with general principles of statutory interpretation. The Court typically has looked to general principles governing the recovery of damages, as well as other settled legal concepts and policy considerations, in fixing the precise contours of broad damages remedies. (Indeed, *Associated General Contractors* itself relied on these factors. See 459 U.S. at 531-544). For example, the Court's interpretation of 42 U.S.C § 1983 has drawn heavily on common law rules and policy concerns regarding damages liability. See, *e.g.*, *Memphis Community School District* v. *Stachura*, 477 U.S. 299 (1986) (applying common law principles); *City of Newport* v. *Fact Concerts, Inc.*, 453 U.S. 247 (1981) (municipalities immune from punitive damages liability on common law and policy grounds); cf. *O'Bannon* v. *Town Court Nursing Center*, 447 U.S. 773 (1980) (Fifth Amendment does not apply to the indirect adverse effects of government action). The same is true of other damages remedies. See, *e.g.*, *Blue Chip Stamps* v. *Manor Drug Stores*, *supra* (Section 10(b)); *Colligan* v. *Activities Club of New York*, 442 F.2d 686 (2d Cir.), cert. denied, 404 U.S. 1004 (1971)

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[3] This conclusion gains additional support from the fact that Congress did not define racketeering activity to include antitrust violations. If the objection to antitrust standing principles had been that *no* such restrictions were justified with respect to the RICO civil action—rather than the concern that an across-the-board competitive injury requirement was inappropriate for a statute not concerned exclusively with injury to competition—Congress would have included antitrust violations under the RICO umbrella in order to free them from the antitrust standing principles. Congress's failure to take this step establishes that its concern was the inappropriateness of the competitive injury requirement in the RICO context, not a general objection to any limitation on recovery of damages under RICO.

(Lanham Act) The extremely broad scope of the RICO civil remedy, coupled with the fact that a successful plaintiff may recover treble damages and attorneys' fees, makes that general approach especially appropriate in this context.[4]

In order to determine the scope of the RICO cause of action, it is necessary—as we have discussed (see pages 14-15, *supra*)—to apply the general principles set forth in *Associated General Contractors* and this Court's other cases in light of the substantive provisions of the RICO statute. To begin with, RICO actually consists of three separate sub-offenses with somewhat different focuses. See pages 7-8, *supra*. We concentrate here on Section 1962(c), which bars "any person" from conducting the affairs of an enterprise "through a pattern of racketeering activity." This Court has stated that "the compensable injury [under Section 1962(c)] necessarily is the harm caused by predicate acts sufficiently related to constitute a pattern, for the essence of the violation is the commission of those acts in connection with the conduct of an enterprise." *Sedima*, 473 U.S. at 497. The focus of the inquiry, therefore, must be on the relationship between the plaintiff's alleged injury and the predicate acts. This

[4] Respondents suggest (Br. in Opp. 14) that *any* limitation on the Section 1964(c) damages remedy is inappropriate because the statute contains a provision stating that it should "be liberally construed to effectuate its remedial purposes." Pub. L. No. 91-452, § 904(a), 84 Stat. 947 (1970). That provision does not mandate mindless expansionism, however. *Pinter* v. *Dahl*, 486 U.S. 622, 652-654 (1988). It is difficult to see how RICO's purpose could be affected adversely by rules limiting the class of plaintiffs entitled to seek treble damages to those whose injuries bear an appropriate relationship to the alleged violation. See *Brandenburg* v. *Seidel*, 859 F.2d 1179, 1189 n.11 (4th Cir. 1988) (RICO's liberal construction clause "obviously [was] not intended to read the traditional proximate cause concerns of tort law completely out of civil RICO"). The Court has deemed such an approach proper under the antitrust laws, statutes with a similar remedial purpose (*Agency Holding Co.*, 483 U.S. at 151). It is equally proper under RICO.

approach also has the salutary effect of eliminating the possibility that plaintiffs will invoke RICO in order to circumvent principles that prevent them from maintaining a damages action based directly on the predicate offense itself.[5]

As under the Clayton Act, "the infinite variety of [RICO] claims that may arise makes it virtually impossible to announce a black-letter rule that will dictate the result in every case." *Associated General Contractors*, 459 U.S. at 536 (footnote omitted). But it is possible to describe in general terms the inquiry that a court should undertake to determine whether a plaintiff may maintain the RICO claim asserted in his complaint. First, the court should examine the nature of the injury to determine whether it is of the type that Congress sought to redress through the predicate offenses relied on by the plaintiff. Second, the court should assess the directness of the relationship between the plaintiff's alleged injury and the alleged misconduct and determine whether the claim could be asserted by more directly injured persons. Third, the court should evaluate whether

[5] The inquiry for RICO claims premised on Sections 1962(a) or (b) differs from that for Section 1962(c) claims. Section 1962(a) focuses on "us[ing] or invest[ing]" income derived from a pattern of racketeering activity. The plaintiff accordingly must show an appropriate relationship between his injury and the use or investment of the allegedly ill-gotten gains. See *Craighead* v. *E.F. Hutton & Co.*, 899 F.2d 485, 494 (6th Cir. 1990); *Quaknine* v. *MacFarlane*, 897 F.2d 75, 82-83 (2d Cir. 1990); *Rose* v. *Bartle*, 871 F.2d 331, 356-358 (3d Cir. 1989); *Grider* v. *Texas Oil & Gas Corp.*, 868 F.2d 1147 (10th Cir.), cert. denied, 110 S. Ct. 76 (1989); but see *Busby* v. *Crown Supply, Inc.*, 896 F.2d 833, 837 (4th Cir. 1990). Because Section 1962(b) targets the use of racketeering activity to "acquire or maintain * * * any interest in or control of any enterprise," the inquiry would focus on the relationship between that conduct and the plaintiff's injury. *Midwest Grinding Co.* v. *Spitz*, 716 F. Supp. 1087, 1091 (N.D. Ill. 1989) (collecting cases). Finally, the analysis of a claim under Section 1962(d), the conspiracy provision, depends on which of the substantive provisions is implicated by the conspiracy.

the plaintiff's damages claim rests on abstract or speculative measures of harm. Fourth, the court should consider whether the damages proceedings would be unduly complex. After assessing all of these factors, the court should "exercise [its] judgment in deciding" whether the plaintiff may maintain the particular RICO damages claim. *Id.* at 537.

B. SIPC May Not Maintain A Section 1962(c) Claim Premised On Violations Of Section 10(b) Because It Was Neither A Purchaser Nor A Seller Of Securities In The Transactions At Issue.

Respondent SIPC based its RICO claim principally on the allegation that petitioner had engaged in a pattern of racketeering activity by committing "offense[s] involving * * * fraud in the sale of securities." 18 U.S.C. § 1961(1)(D). SIPC's contention is that petitioner violated Section 10(b) of the Securities Exchange Act and Rule 10b-5. See Pet. App. 10a-11a.[6] It is undisputed, however, that SIPC neither purchased nor sold securities in the transactions at issue. SIPC should not be able to rely upon Section 10(b) violations to establish its RICO claim, because—under the principles set forth above—that alleged misconduct does not bear a sufficiently close relationship to any injury it suffered.

More than 15 years ago, in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, this Court considered "what limita-

[6] Section 1961(1)(D)'s reference to "offenses" appears to point to the criminal provision of the federal securities laws, Section 32(a) of the Securities Exchange Act, 15 U.S.C. § 78ff. That provision, in turn, refers back to the substantive sections of the securities laws and thereby incorporates Section 10(b). SIPC (Br. in Opp. 14-15) emphasizes that the predicate offense is a *criminal* violation of the securities laws, and points out that the purchaser-seller requirement is not an element of the criminal offense. But that fact is irrelevant because the focus of our analysis is the separate requirement—imposed by Section 1964(c)—of an appropriate relationship between the predicate act and the plaintiff's injury.

tions there are on the class of plaintiffs who may maintain a private cause of action for money damages for violation of Rule 10b-5" (421 U.S. at 727). The Court reaffirmed the longstanding rule—first recognized in *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952)—that "the plaintiff class for purposes of § 10(b) and Rule 10b-5 private damage actions is limited to purchasers and sellers of securities" (*Blue Chip Stamps*, 421 U.S. at 731-732). That holding is dispositive here.

The purpose of the Court's analysis in *Blue Chip Stamps* was precisely the same as the purpose of the present inquiry—to determine whether an injury sustained by persons who neither purchased nor sold securities is sufficiently related to a violation of Section 10(b) to give rise to a right to recover damages. Moreover, the considerations that the Court looked to in *Blue Chip Stamps* are the very factors that are controlling under Section 1964(c). First, the Court examined the statute itself to determine whether the injury suffered by the plaintiffs in that case was the type that Congress sought to redress in enacting Section 10(b). It concluded that the language and structure of the statute, while not dispositive, indicated that Congress intended to reach only injuries to those who purchased or sold securities. 421 U.S. at 733-736. See also *id.* at 755-760 (Powell, J., concurring).

The Court went on to consider several "policy considerations" in determining the appropriate reach of damages liability. 421 U.S. at 737. The Court observed that overturning the *Birnbaum* rule would increase the complexity of securities fraud litigation. *Id.* at 740-743. The Court also found that claims by persons who were neither purchasers nor sellers would rest to a considerable degree on speculation. As the Court explained,

> [i]n the absence of the *Birnbaum* rule, * * * * [p]laintiff's proof would not be that he purchased or

> sold stock, a fact which would be capable of documentary verification in most situations, but instead that he decided *not* to purchase or sell stock. Plaintiff's entire testimony could be dependent upon uncorroborated oral evidence of many of the crucial elements of his claim, and still be sufficient to go to the jury. The jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant.

Id. at 745-746 (emphasis in original). The Court concluded that "[i]n the absence of the *Birnbaum* doctrine, bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass." *Id.* at 747. See also *id.* at 760-761 (Powell, J., concurring). To avoid the "peculiarly high degree" of danger that defendants would be subjected to liability on the basis of false oral testimony (421 U.S. at 743), the Court affirmed that only purchasers and sellers of securities may maintain damages claims under Section 10(b) and Rule 10b-5.

The definition of the appropriate plaintiff class should not change when—instead of asserting a claim under Section 10(b)—a plaintiff relies on that provision indirectly, by pleading Section 10(b) violations as predicates for an alleged Section 1962(c) RICO violation. As the Court observed in *Sedima*, the relevant injury for purposes of Section 1962(c) is the injury caused by the predicate acts. 473 U.S. at 497. Where the predicate act is an alleged Section 10(b) violation, the question is whether the injury asserted by the plaintiff is sufficiently related to the violation of Section 10(b) to permit recovery of damages. *Blue Chip Stamps* establishes that SIPC's alleged injury is *not* appropriately related to the alleged violations of

Section 10(b). Accordingly, SIPC may not maintain a damages action predicated on those violations.

Certainly nothing has happened since *Blue Chip Stamps* was decided that would alter the Court's analysis of Section 10(b)'s language and structure. Indeed, the language of RICO provides independent support for the conclusion that RICO actions predicated on Section 10(b) were intended by Congress to focus on actual purchasers and sellers of securities. RICO describes Section 10(b) and related offenses by referring to them as "offense[s] involving * * * fraud *in the sale of securities*" (18 U.S.C. § 1961(1)(D) (emphasis added)). Congress's choice of that terminology indicates that Congress's intent in including these offenses under the RICO umbrella was to combat fraud in connection with securities *sales*. As the Fourth Circuit has concluded, the language "suggests the pivotal role of the actual sales transaction." *International Data Bank* v. *Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987). See also Bridges, *Private RICO Litigation Based Upon "Fraud in the Sale of Securities,"* 18 Ga. L. Rev. 43, 62 (1983).

The inquiry under RICO also encompasses the other factors relied on in *Blue Chip Stamps*—the dangers of complex litigation and speculative damages claims. Those dangers are "increased, not diminished" by the dramatically greater recovery available under RICO, treble damages and attorneys' fees. *International Data Bank*, 812 F.2d at 153. "The larger potential recovery under RICO enhances the 'settlement value' and 'nuisance' potential of a securities fraud action—both dangers to which the *Blue Chip Stamps* Court adverted." *Ibid.* Moreover, "[t]he problems of proof noted in *Blue Chip Stamps* would also inhere" under RICO because "[n]on-sellers and non-buyers of securities would be advancing their own largely non-contradictable oral testimony about a non-event, namely their failure to sell or purchase stock. Problems of proof with respect to causation would be endless." *Ibid.*

The rationale of *Blue Chip Stamps* therefore also applies to RICO claims predicated on securities fraud. *International Data Bank*, 812 F.2d at 153; *Brannan* v. *Eisenstein*, 804 F.2d 1041, 1046 (8th Cir. 1986).[7]

That result comports with common sense. "Congress * * * did not write the RICO statute in a vacuum. It enacted this legislation * * * against the developed backdrop of almost forty years of federal securities law." *International Data Bank*, 812 F.2d at 152. A key element of that background was the *Birnbaum* rule, which, as the Court observed in *Blue Chip Stamps*, had been accepted by the lower courts for a quarter century. 421 U.S. at 731-732. "If Congress had intended the drastic result of overturning this consensus, it surely would have done so in a more explicit way." *Internationl Data Bank*, 812 F.2d at 152. See also *Sedima*, 473 U.S. at 505 (Marshall, J., dissenting) (RICO should not be interpreted to "eliminate[] decades of legislative and judicial development of private civil remedies under the federal securities laws").

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[7] Respondents suggest (Br. in Opp. 12) that the *Blue Chip Stamps* analysis is inapplicable here because the Court observed in that case that Congress could create a cause of action that expressly authorized recovery of damages by nonpurchasers and nonsellers. See 421 U.S. at 748-749. But Congress did not enact such an express remedy in the RICO statute. Nothing in Section 1964(c) mandates that such parties be permitted to maintain RICO claims. Rather, by basing Section 1964(c) on Section 4 of the Clayton Act, Congress made clear that damages recovery is limited to those plaintiffs whose injury bears an appropriate relationship to the misconduct.

The court of appeals relied (Pet. App. 12a-13a) on the lack of an express purchaser or seller standing requirement in the language of Section 1964(c) in concluding that the *Birnbaum* rule does not apply to RICO civil actions predicated on securities fraud. To begin with, as we have discussed, the language of Section 1961(1)(D) focuses on actual sales. In addition, the express language of Section 1964(c) requires that a determination be made regarding the appropriateness of the relationship between the plaintiff's injury and the alleged misconduct. Here, that determination can only be that a nonpurchaser-nonseller such as SIPC may not maintain a RICO action based on securities fraud.

It simply is inconceivable that Congress intended to override the carefully delineated limitations on damages relief contained in the prexisting remedial scheme under the federal securities laws when it included securities fraud in RICO's definition of racketeering activity. As this Court pointed out in *Blue Chip Stamps*, 421 U.S. at 746-747, the *Birnbaum* rule protects against speculative damages resting entirely on post-hoc explanations for the plaintiff's inaction. "A rule allowing this type of open-ended litigation would itself be an invitation to fraud." *Id.* at 761 (Powell, J., concurring). Congress's silence provides no justification for eliminating such an important principle, especially in a context in which the danger of unfounded claims would be *increased* by the prospect of recovering treble damages and attorneys' fees.

Congress surely intended that these interrelated statutes would be interpreted so as to strengthen enforcement of the securities laws rather than to frustrate or subvert the principles embodied in those statutes. That intention will be effectuated only if RICO is construed so that it is consistent with the remedial scheme under the securities laws. Indeed, it would be perverse to interpret RICO in a manner that guts the policy of the securities laws by overriding settled limits on damages liability, thereby opening the door to a deluge of frivolous lawsuits that would lead to the very adverse consequences that were the basis for the Court's determination in *Blue Chip Stamps*. The only reasonable way to construe the RICO statute is to apply the *Blue Chip Stamps* rule to RICO actions predicated on securities fraud. See, *e.g.*, *United Savings Ass'n of Texas* v. *Timbers of Inwood Forest Associates*, 484 U.S. 365, 380 (1988) ("[s]uch a major change in the existing rules would not likely have been made without specific provision in the text of the statute; it is most improbable that it would have been made without even any mention in the legislative history") (citation omitted). As the Fourth Circuit ob-

served, "[w]here a predicate offense already has a well-developed private right of action under federal law, we think the better view is that Congress meant for RICO simply to expand the range of *remedies* by allowing for treble damages and attorneys' fees, rather than to summarily overturn the settled law." *International Data Bank*, 812 F.2d at 153 (emphasis in original).

This Court has in other contexts construed seemingly broad federal remedies to avoid conflicts with well-settled limits on damages liability. The immunities recognized under Section 1983, for example, rest on the Court's determination "that in enacting § 1983, Congress did not intend to override well-established immunities or defenses under the common law." *Will* v. *Michigan Dep't of State Police*, 491 U.S. 58, 67 (1989). See also *City of Newport* v. *Fact Concerts, Inc.*, 453 U.S. at 258. Here, Congress included securities fraud as a predicate act under RICO against the background of the well-established remedial scheme under the securities laws. The conclusion that Congress did not intend to override settled limits on damages liability is inescapable in this context as well. See also pages 15-16, *supra*. Cf. *Train* v. *Colorado Public Interest Research Group, Inc.*, 426 U.S. 1, 23-24 (1976).

Indeed, the evidence that Congress intended to limit the RICO damages remedy in this manner is stronger than the evidence that the Court has relied on in construing Section 1983 because the very language of Section 1964(c) authorizes the court to determine in each case whether the plaintiff is an appropriate party to recover damages. The outcome of that determination in this context is clear: a plaintiff should be able to maintain a Section 1962(c) RICO damages action predicated on securities fraud offenses only if that plaintiff purchased or sold the securities in question.[8]

[8] Of course, the *Birnbaum* rule is not the only such limitation applicable to RICO damages actions premised on securities fraud. Other principles designed to determine whether the plaintiff's relationship to the alleged misconduct is sufficient to justify a damages remedy—such as, for example, loss causation rules—also apply. See, *e.g.*, *Bastian* v. *Petren Resources Corp.*, 892 F.2d 680, 686 (7th Cir.), cert. denied, 110 S. Ct. 2590 (1990); cf. *Sperber* v. *Boesky*, 849 F.2d 60, 63-64 (2d Cir. 1988); *Pujol* v. *Shearson/American Express*, 829 F.2d 1201, 1204-1205 (1st Cir. 1987).

C. SIPC May Not Circumvent The Purchaser/Seller Rule By Recharacterizing The Alleged Misconduct As Violations Of The Mail And Wire Fraud Statutes.

SIPC observes (Br. in Opp. 15-16) that its RICO claims were not predicated simply on securities fraud but also alleged that petitioner engaged in mail and wire fraud, in violation of 18 U.S.C. §§ 1341, 1343. Because the latter offenses also constitute racketeering activity (see 18 U.S.C. § 1961(1)(B)), SIPC contends that even if it may not base its RICO claim on securities fraud, it may proceed under RICO by simply recharacterizing identical conduct as mail and wire fraud. However, a mere shift in labels cannot relieve SIPC of the requirement of demonstrating that its injury bears an appropriate relationship to the alleged misconduct.

In applying the general principles set forth above (see pages 11-18) to determine whether a plaintiff's injury bears an appropriate relationship to a mail or wire fraud claim, courts should look to two sources of guidance. First, where—as in the securities fraud context, for example—federal law contains an offense targeting the precise type of fraud alleged by the plaintiff and, moreover, that offense is a predicate under the RICO statute, the limits on the plaintiff class eligible to recover damages under that specific offense should apply in determining whether the plaintiff may maintain a RICO claim predicated on the more general mail and wire fraud offenses. Second, if there is no more specific offense to look to for guidance, the common law principles governing recovery of tort damages for fraud provide an appropriate source for standards defining the class of plaintiffs

eligible to maintain RICO actions predicated on mail or wire fraud.

The mail and wire fraud statutes are exceedingly broad. Frequently, conduct that is violative of other, more specifically drawn federal statutes may also be characterized as mail or wire fraud. *Sedima*, 473 U.S. at 501-504 (Marshall, J., dissenting); *Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking, and Business Law* 239-243 (1985); Mathews, *Shifting the Burden of Losses in the Securities Markets: The Role of Civil RICO in Securities Litigation*, 65 Notre Dame L. Rev. 896, 939-941 (1990). The most obvious example of this phenomenon is the overlap between the federal securities laws on the one hand and the mail and wire fraud statutes on the other. The two sets of statutes are directed at the same type of harm—fraud. Few securities frauds occur without some resort to the mails or the telephone. Thus, any securities fraud claim could easily be formulated as a mail or wire fraud claim. The principles defining the class of appropriate plaintiffs under Section 10(b)—the *Birnbaum* rule and loss causation requirements, for example—are designed to identify those plaintiffs whose injury bears the requisite appropriate connection to the fraudulent activity. The same rules should therefore apply when the very same conduct is relabeled as mail or wire fraud.

Certainly the dangers of speculative damages claims and complex litigation (see pages 19-21, *supra*) would not be reduced simply because the plaintiff seeks recovery under a different legal label. "A rule allowing this type of open-ended litigation would [still] * * * be an invitation to fraud." *Blue Chip Stamps*, 421 U.S. at 761 (Powell, J., concurring) (footnote omitted). And, although the elements of the offenses are different, where the conduct alleged by the plaintiff satisfies all of the substantive requirements necessary to establish a Section 10(b) violation (and the only obstacle to maintaining a

claim under that statute is the *Birnbaum* rule or proximate cause standard), the principle of recovery that is the product of Congress's focused consideration of the issue should govern under the more general fraud offenses as well. Accord, *Brannan* v. *Eisenstein*, 804 F.2d at 1046-1047.

A contrary result would simply make no sense. Congress could not have intended to allow plaintiffs to circumvent the limitations on recovery of damages under the securities laws by casting their RICO claims in terms of mail and wire fraud. For the reasons we have discussed in connection with the securities fraud claims (see pages 22-24, *supra*), settled precedent weighs heavily against construing RICO to override these well established rules concerning limits on damages liability. Rather, the RICO damages remedy should be interpreted in a manner consistent with the federal securities law civil remedy. A plaintiff alleging conduct that constitutes securities fraud should be required to satisfy the standing rules governing securities fraud actions, even if he pleads his claim under the mail and wire fraud statutes. Cf. *Laird* v. *Nelms*, 406 U.S. 797, 802 (1972).

A second source of guidance in fixing the class of plaintiffs entitled to invoke mail and wire fraud as predicate acts for a Section 1962(c) violation are the common law rules governing recovery of damages in fraud actions. A number of those rules—the requirements that the plaintiff be a target of the fraudulent scheme and that the plaintiff prove reliance and causation (including proximate causation)[9]—were designed to limit damages liability to those plaintiffs whose injury is appropriately related to the defendant's misconduct.

Just as *Blue Chip Stamps* analyzed the scope of the appropriate plaintiff class under Section 10(b) and is

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[9] See generally *Restatement (Second) of Torts* §§ 525-552C (1977).

therefore relevant to RICO claims predicated on Section 10(b) violations (and on fraud violations generally), these common law rules are the product of hundreds of years of analysis regarding the contours of the appropriate plaintiff class for fraud claims. The common law principles should therefore guide the availability of RICO claims predicated on mail and wire fraud violations. Indeed, these rules are based in large part on the considerations identified in *Associated General Contractors*—ensuring that the plaintiff is in the class protected by the legal right, weeding out attenuated claims of injury, and eliminating damages claims grounded in speculation.

The lower courts have generally followed this approach, concluding that a plaintiff must establish that he reasonably relied on the alleged misrepresentation in order to recover damages in a RICO action predicated on mail or wire fraud.[10] The plaintiff also must show that he was

[10] *Pelletier* v. *Zweifel*, 921 F.2d 1465, 1499-1500 (11th Cir. 1991) ("when the alleged predicate act is mail or wire fraud, the plaintiff * * * must have relied to his detriment on misrepresentations made in furtherance of that scheme"); *County of Suffolk* v. *Long Island Lighting Co.*, 907 F.2d 1295, 1311 (2d Cir. 1990) (necessary for plaintiff to show that misrepresentations were relied upon); *Brandenburg* v. *Seidel*, 859 F.2d 1179, 1188 n.10 (4th Cir. 1988) ("while * * * it is not necessary to establish detrimental reliance by the victim in order to make out a violation of the federal mail fraud statute, such reliance is necessary to establish injury to business or property '*by reason of*' a predicate act of mail fraud within the meaning of § 1964(c)") (citations omitted, emphasis added); *Blount Financial Serv.* v. *Walter E. Heller Co.*, 819 F.2d 151, 152 (6th Cir. 1987) ("RICO civil complaint must state with particularity * * * the plaintiff's reliance."); see also *Kehr Packages, Inc.* v. *Fidelcor, Inc.*, 926 F.2d 1406, 1416 & n.3 (3d Cir. 1991) (noting that reliance must be reasonable). The Fifth Circuit has indicated to the contrary (see *Armco Indus. Credit Corp.* v. *SLF Warehouse Corp.*, 782 F.2d 475, 481-82 (5th Cir. 1986)), but a subsequent decision points in the other direction. *Zervas* v. *Faulkner*, 861 F.2d 823, 834-835 (5th Cir. 1988) (rejecting "but for" causation as sufficient, and generally endorsing the *Brandenburg* court's approach to proof of proximate cause).

an intended target of the fraudulent scheme.[11] These limitations serve to further limit the class of persons who may maintain RICO actions predicated on mail and wire fraud.

Here, SIPC's mail and wire fraud claims are subject to the same limitations as its securities fraud claims. SIPC accordingly may not maintain a RICO Section 1962(c) damages action predicated on violations of the mail and wire fraud statutes.

[11] *Pelletier*, 921 F.2d at 1499 ("when the alleged predicate act is mail or wire fraud, the plaintiff must have been a target of the scheme to defraud"); *Sperber* v. *Boesky*, 849 F.2d at 64-66 (foreseeability of injury to plaintiffs did not cure fact that they were not targets of the scheme); *Pujol*, 829 F.2d at 1205; see *Brandenburg*, 859 F.2d at 1188 (absence of directly made misrepresentations exculpatory); *Zervas*, 861 F.2d at 835 (conspiracy did not have as one of its objects the inflation of land values that allegedly caused plaintiff's injury, thus barring recovery under Section 1964(c)).

CONCLUSION

The judgment of the court of appeals should be reversed.

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Supreme Court of the United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,

Petitioner,

—vs.—

SECURITIES INVESTOR PROTECTION CORPORATION, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

This *Amicus Curiae* brief addresses the sole question upon which this Court granted the petition for writ of certiorari, *to wit*:

> Whether a party which was neither a purchaser nor a seller of securities, and for that reason lacked standing to sue under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, is free of that limitation on standing when presenting essentially the same claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-727

ROBERT G. HOLMES, JR.,

Petitioner,

—vs.—

SECURITIES INVESTOR PROTECTION CORPORATION, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "Institute") respectfully submits this brief as *amicus curiae* pursuant to Rule 37.3 of the Rules of this Court in support of petitioner, Robert G. Holmes, Jr., and urges that this Court reverse the judgment of the United States Court of Appeals for the Ninth Circuit, entered in these proceedings on August 3, 1990 and reported at 908 F.2d 1461 (9th Cir. 1990), insofar as it reversed the Order of the United States

District Court for the Central District of California. This brief is submitted on consent of the parties, and their written consents are being filed with the Clerk of the Court contemporaneously herewith.

INTEREST OF THE INSTITUTE AS *AMICUS CURIAE*

The Institute is the national professional accounting organization, all of whose more than 300,000 members are certified public accountants. Among the Institute's purposes are the promotion and maintenance of high professional standards of practice. In the pursuit of those ends, the Institute has come to be accepted as the authoritative source of standards and procedures in its field.

As the issuer of these standards, the Institute has a profound interest in the scope and bases of civil liability sought to be imposed on auditors in connection with their performance of professional engagements under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 ("RICO"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) ("Section 10(b)" and the "1934 Act") and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1986) ("Rule 10b-5") promulgated thereunder. The Institute's substantial and legitimate interest in this body of law has long been recognized both by this Court and the Congress.[1]

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1 The Institute was invited to and did submit a position paper to the United States Senate addressing the proposed scope of civil liabilities and damages under the 1934 Act. *Hearings on S. Res. 84 (72d Cong.), S. Res. 56, and S. Res. 97 Before the Comm. on Banking and Currency*, 73d Cong., 1st Sess., pt. 15, at 7207-10 (1934). Furthermore, this Court has permitted the Institute to file briefs *amici curiae* on related securities laws issues in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979); *Aaron v. SEC*, 446 U.S. 680 (1980); *Ross v. A. H. Robins Co.*, 607 F.2d 545 (2d Cir. 1979), *cert. denied*, *(footnote continued)*

Although this case does not involve a claim against a member of the accounting profession, the potential impact of the Ninth Circuit's ruling on accountants is severe. Accountants play an integral role in the dissemination of financial information pursuant to the federal securities laws. When auditors express opinions on financial statements, they become exposed to suits brought by investors, creditors and others who may claim to have relied upon those statements in making investment decisions or entering into business transactions with auditors' clients. Upon the financial collapse of corporations, outside professionals, such as accountants, like other surviving solvent parties, are "targets of opportunity" in private RICO actions for treble damages. Dramatic expansions of civil liability under RICO, as exemplified by the decision below, foster "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739, *reh'g denied*, 423 U.S. 884 (1975).

The Ninth Circuit held that the rule of *Blue Chip Stamps* and *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), limiting private civil actions for damages under Section 10(b) and Rule 10b-5 to plaintiffs who are actual purchasers or sellers of securities, is inapplicable in civil RICO actions predicated on "fraud in the sale of securities." 18 U.S.C. § 1961(1)(D). In reaching this anomalous result, the Court below disregarded the language and structure of RICO and swept aside a half-century of federal securities law. Under the decision of the Court below, a civil plaintiff may assert a securities fraud claim as a violation of RICO, even though the same plaintiff would have been barred from asserting the same claim under the federal securities laws. This opens the floodgates to a new breed of abusive RICO litigation that will plague legitimate

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(continued footnote)

446 U.S. 946 (1980); and *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). On the subject of RICO, the Institute participated as *amicus curiae* in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), and *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229 (1989).

businesses and their certified public accountants as well as the federal courts.

Members of the Institute, therefore, along with other professionals, have a vital interest in urging this Court to adopt an interpretation of RICO that not only will dispose of the case before the Court, but will do so in a manner that brings consistency, predictability and coherence to the interpretation of RICO and the antifraud provisions of the federal securities laws.

STATEMENT OF THE CASE

Petitioner, Robert G. Holmes, Jr., is the founder, chief executive officer, president, and a major stockholder of Aero Systems, Inc. ("Aero"). Mr. Holmes also was a shareholder in Bunnington Corp. ("Bunnington"). Respondent, the Securities Investor Protection Corporation ("SIPC"), is a nonprofit membership corporation consisting of most registered securities brokers and dealers.

In July, 1981, the SIPC instituted liquidation proceedings against two brokerage houses: First State Securities Corp. ("FSSC") and Joseph Sebag, Inc. ("Sebag"). Acting as liquidator of the brokerage houses, the SIPC alleged that it had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

In July, 1983, the SIPC, together with the trustees appointed for the liquidation of the failed brokerages, commenced litigation in the United States District Court for the Central District of California against seventy-five defendants, alleging securities fraud in violation of Section 10(b) of the 1934 Act and Rule 10b-5 thereunder, a conspiracy under RICO, common law fraud, and breach of fiduciary duty. It was alleged that from 1964 through July 1981, the defendants engaged in a scheme to manipulate the stock of six companies, including Aero and Bunnington, traded in the over-the-counter market, and that defendants used FSSC and Sebag to further the scheme.

Petitioner moved for summary judgment in the District Court on the ground, *inter alia*, that SIPC had no standing to maintain claims against him under Section 10(b) and Rule 10b-5, or under RICO, because SIPC was not a purchaser or seller of securities. Petitioner also argued that plaintiffs lacked standing under RICO because their alleged injuries were not caused by reason of the alleged RICO violation. The SIPC was not a purchaser or seller of any securities and failed to show, in the District Court, that it was subrogated to the claims of any of FSSC's or Sebag's customers who had unauthorized transactions in their accounts and who were themselves purchasers or sellers of securities. *See* Petition for Writ of Certiorari of Robert G. Holmes, Jr., at 6.

The District Court granted petitioner's motion for summary judgment, holding, *inter alia*, that: (1) SIPC was not a purchaser or seller of securities and it therefore lacked standing to assert RICO claims predicated upon a violation of Section 10(b) and Rule 10b-5; and (2) the injuries alleged by plaintiffs were not causally connected to petitioner's conduct, and thus, petitioner was entitled to summary judgment on the claims under RICO and the federal securities laws.

The Ninth Circuit reversed the judgment of the District Court, and held that SIPC did not have to be a purchaser or seller of securities to assert a RICO claim predicated upon alleged Section 10(b) and Rule 10b-5 violations. The Court reasoned that the language of RICO granting a private right of action, 18 U.S.C. § 1964(c), did not impose a purchaser/seller requirement upon private plaintiffs; however, the Court failed to address the specific language of 18 U.S.C. § 1961(1)(D), upon which SIPC relied, which requires a showing of "fraud in the *sale* of securities" (emphasis added). The Ninth Circuit concluded that this Court's decision in *Blue Chip Stamps* need not be followed in a RICO case alleging securities fraud because the purchaser/seller requirement announced in *Blue Chip Stamps* arose in the context of a private right of action for securities fraud that was "court created." *SIPC v. Vigman*, 908 F.2d 1461, 1466

(9th Cir. 1990), *cert. granted in part sub nom. Holmes v. SIPC*, 111 S. Ct. 1618 (1991).

SUMMARY OF ARGUMENT

Delineating the proper contours of a private right of action under RICO, predicated on a claim of "fraud in the sale of securities," requires an exacting analysis of the statute, its structure, and its relationship with the existing federal securities laws. The Court below eschewed this approach. Instead, it declared that strangers to a securities transaction could have standing under RICO to assert securities fraud claims, upon the mere allegation that they were somehow injured by a fraud. This result circumvents a half-century of carefully-crafted federal securities law, particularly the rule of *Blue Chip Stamps* restricting the plaintiff class asserting Section 10(b) claims to actual purchasers and sellers of securities, and invites those with untenable federal securities fraud claims to assert the very same claims, in federal court, under the guise of RICO. The decision below offers an added unwarranted and unwise litigation incentive; the repackaged securities claim is rewarded with the promise of treble damages and attorneys' fees, none of which would be available even if the securities fraud claim were cognizable. RICO was not intended to give life to defective federal securities law claims much less to endow them with windfall recovery potential; however, that is precisely what the Court below has achieved.

The rationale and decision of the Court below are flawed as a matter of law and policy, and should be rejected. In finding that RICO did not impose a purchaser/seller requirement upon private RICO plaintiffs, the Court below focused exclusively upon the broad language of RICO's private right of action. 18 U.S.C. § 1964(c). The Court failed to recognize, however, that no private right of action accrues until, *inter alia*, plaintiff can demonstrate the existence of "racketeering activity," namely, "fraud in the *sale* of securities." 18 U.S.C. § 1961(1)(D) (emphasis added). The language of the predicate act itself and its appropriate structural relationship

to the 1934 Act separately and together compel the conclusion that a private action for treble damages under RICO should be limited to those who were defrauded in the actual sale of securities.

The same result is dictated, for similar reasons of statutory construction, by the requirement of RICO that SIPC establish that its alleged injury was caused *by reason of* the RICO violation. 18 U.S.C. § 1964(c). SIPC was neither a purchaser nor seller of securities, and its injury was not proximately caused by the RICO violation. *Blue Chip Stamps* embodies the sound policy decision that bystanders to the securities marketing process should not be accorded a private right of action under Section 10(b). The injuries alleged by SIPC—a stranger to any sales transaction and the target of no racketeering activity—should not be cognizable under RICO.

The decision below has grave ramifications for legitimate businesses, including accounting firms, and the securities markets. By exempting RICO plaintiffs from the purchaser/seller requirement, the decision below will contribute to the continuing growth of RICO actions against accountants. The exposure to risk of treble damages, potentially irreparable harm to professional reputation, and time-consuming and costly litigation, all tend to promote extortive settlements. This consequence imposes considerable societal costs. The unwarranted expansion of accountants' liability may impede or prevent the critical flow of financial information as accounting services become either more costly or unavailable, and thereby harm investors, the capital markets, and competition. By subjecting accountants and others to potentially limitless liability in actions initiated by strangers to securities transactions, the Court below has announced a result that is unsupportable as a matter of law or public policy. The decision of the Ninth Circuit should be reversed.

ARGUMENT

POINT I

THE DECISION BELOW DISREGARDED THE PLAIN LANGUAGE AND STRUCTURE OF RICO.

Congress has provided that "[t]he provisions of [RICO] shall be liberally construed to effectuate its remedial purposes," Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 904(a), 84 Stat. 922, 947, and this Court has noted that "RICO is to be read broadly." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497 (1985). These admonitions, however, cannot override the primacy of the statutory language of RICO. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979). In the RICO context, this Court has held: "we look first to its language. If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.' " *United States v. Turkette*, 452 U.S. 576, 580 (1981) (citation omitted); *Russello v. United States*, 464 U.S. 16, 20 (1983); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201, *reh'g denied*, 425 U.S. 986 (1976) (in construing Section 10(b), a remedial statute, this Court held that "[t]he language of a statute controls when sufficiently clear in its context"); *accord Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977). In construing RICO, the intention of Congress is "best determined by the statutory language that it chooses." *Sedima*, 473 U.S. at 495 n.13.

This Court should not construe RICO in a manner that would supersede and eclipse 50 years of reasoned adjudication of the federal securities laws. The provisions of RICO, particularly sections 1961(1)(D), 1962, and 1964(c), should be construed to harmonize, and function in coordination, with the federal securities laws. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 466 (1969) ("the inter-dependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen"); *Randall v. Loftsgaarden*, 478 U.S. 647, 661 (1986).

A. A RICO Action, Predicated On Allegations Of Securities Fraud, Is Properly Confined To Private Plaintiffs Who Were Parties To The Sale Transaction.

Section 1964(c) of RICO authorizes a private suit by "[a]ny person injured in his business or property by reason of a violation of § 1962." 18 U.S.C. § 1964(c). As held by this Court, "[i]f the defendant engages in a pattern of racketeering activity in a manner forbidden by [Section 1962], and the racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim under § 1964(c)." *Sedima*, 473 U.S. at 495. The individual sections of RICO are interrelated and integrated within a single statute, and under the principle of *in pari materia*, should be construed together. *See Sullivan v. Everhart*, 110 S. Ct. 960, 966 (1990) (to be reported at 494 U.S. 83); *Erlenbaugh v. United States*, 409 U.S. 239, 244 (1972).

Section 1961(1)(D)—relied upon by SIPC to establish a RICO violation—defines racketeering activity as, *inter alia*, "any offense involving . . . fraud in the sale of securities . . . punishable under any law of the United States." This language is sufficiently clear in its context[2] and should be

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2 The term "racketeering activity" is defined in 18 U.S.C. § 1961, by a list containing specific State and Federal crimes characteristically committed by members of organized crime. McClellan, *The Organized Crime Act (S. 30) Or Its Critics: Which Threatens Civil Liberties?*, 46 NOTRE DAME LAW. 55, 142 (1970). The list of predicate acts was modeled on the listing of crimes for which Congress authorized electronic surveillance. *Id.* at 144. In designating specific predicate acts in Section 1961, Congress intended to bring existing crimes within RICO's reach, not to modify such crimes or create new ones. *Id.*

By denominating "fraud in the sale of securities" as a form of racketeering activity, Congress did not intend to create a "federal common law of fraud." *Bayly Corp. v. Marantette*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,834, at 94,291 (D.D.C. Oct. 19, 1982). In other words, RICO "does not make criminal conduct that before its enactment was not already prohibited, since its application depends on the existence of 'racketeering activity' that violates an independent criminal statute." Blakey & Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts—Criminal and Civil Rem-*

(footnote continued)

applied as written. Resort to legislative history is neither necessary nor helpful.[3]

Section 1961(1)(D) imposes liability only for fraud in the *sale* of securities, and thus, by its unambiguous terms, confers standing only upon those defrauded in the manner proscribed, the actual purchasers and sellers of securities who are parties to the "sale". *See International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987) (hereinafter "*Zepkin*") (standing denied where plaintiff was not a purchaser or seller of securities); *see also First Pacific Bancorp, Inc. v. Bro*, 847 F.2d 542 (9th Cir. 1988) (violations of Sections 13(d) and 14(e) of the 1934 Act cannot be RICO securities fraud predicate acts because neither provision embraces fraud in the sale of a security).

(continued footnote)

edies, 53 TEMP. L.Q. 1009, 1021 n.71 (1980). Thus, by its structure and language, Section 1961(1)(D) defines racketeering activity as including "fraud in the sale of securities," but only to the extent such offense is punishable under existing federal criminal law.

3 Even if considered, the legislative history of RICO sheds little light upon the rationale of Congress in designating "fraud in the sale of securities" as one form of racketeering activity. One respected commentator has observed:

> How the . . . phrase got into the definition [of racketeering activity]—whose fourth category couples it with bankruptcy fraud and offenses involving dangerous drugs—is no more clear than what "fraud" means in this context. The closest reference in the legislative history is (in the testimony of J. Edgar Hoover) to "thefts of securities from brokerage houses," in a number of which "close associates and relatives of La Cosa Nostra figures are known to be involved."

L. Loss, FUNDAMENTALS OF SECURITIES REGULATION 711 (1988) (footnote omitted). The Congressional Statement of Findings and Purpose accompanying RICO states that: "organized crime activities in the United States weaken the stability of the Nation's economic system, *harm innocent investors* and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens." 84 Stat. 922, 923 (emphasis added).

The well reasoned decision of the Court of Appeals for the Fourth Circuit in *Zepkin*, 812 F.2d at 152, supports this conclusion. There the Court held: "[t]he statutory language describing the predicate offense—'fraud in the sale of securities'—is . . . narrow and suggests the pivotal role of the actual sales transaction." *Id.* Without deciding whether the term "fraud in the sale of securities" in 18 U.S.C. § 1961(1)(D) limits, by its own terms, RICO standing to actual parties to the sale, or merely incorporates the standing requirements of federal securities law to the same effect, the Fourth Circuit held that where the RICO plaintiff pleads a Rule 10b-5 predicate offense, standing is limited to the actual purchaser or seller of securities. *Id.* (citing MacIntosh, *Racketeer Influenced and Corrupt Organizations Act: Powerful New Tool of The Defrauded Securities Plaintiff*, 31 KAN. L. REV. 7, 37 (1982)).[4]

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4 Most of the lower courts that have considered the question have adopted this view and, similarly relying on the language of RICO itself and its coordination with the 1934 Act, have rejected civil RICO claims, predicated on Section 10(b) and Rule 10b-5, where the private plaintiff was not a purchaser or seller of securities. *Brannan v. Eisenstein*, 804 F.2d 1041, 1046 (8th Cir. 1986); *Viacom Int'l Inc. v. Icahn*, 747 F. Supp. 205, 210 (S.D.N.Y. 1990); *Kravetz v. Brukenfeld*, 591 F. Supp. 1383, 1388, 1390 (S.D.N.Y. 1984); *Chief Consol. Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1194 (D. Utah 1989); *see also First Pacific Bancorp., Inc. v. Bro*, 847 F.2d 542, 546-47 (9th Cir. 1988) (relying upon *Zepkin*, the Court held that the statutory language of 18 U.S.C. § 1961(1)(D) required "evidence of a sale"); *Reliance Ins. Co. v. Eisner & Lubin*, 685 F. Supp. 449, 456-57 (D.N.J. 1988) (where plaintiff was not a purchaser or seller for purposes of 10b-5 claim, the claim was not considered for RICO purposes), *aff'd*, 897 F.2d 523 (3d Cir. 1990) (*see* 897 F.2d 521); *Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 17-18 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984) (plaintiff's lack of Rule 10b-5 standing precluded a civil RICO claim by plaintiff on the same alleged securities violations); *In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668, 683-84 (S.D.N.Y. 1990) ("securities fraud is only a predicate offense if the fraud occurs in the actual *sale* of a security"). *But see Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir. 1987). The weight of persuasive authority supports the view of the Fourth Circuit. *See, e.g.*, Mathews, *Shifting the Burden of Losses In the Securities Markets: The Role*

(footnote continued)

This Court's analysis of the language of Section 10(b) in *Blue Chip Stamps*, and conclusion that it contains a purchaser/seller standing requirement, calls for a similar construction of Section 1961(1)(D) to restrict the potential class of RICO plaintiffs to actual parties to the sales transaction. In *Blue Chip Stamps*, this Court held that the language of Section 10(b) of the 1934 Act, proscribing fraud "in connection with the *purchase or sale*" of securities, was properly interpreted to reach only those injuries suffered by defrauded purchasers or sellers of securities. *Blue Chip Stamps*, 421 U.S. at 731, 733 (citing with approval *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952)). Section 1961(1)(D), proscribing "fraud in the *sale* of securities," should be construed to protect only those parties defrauded in the actual sales transaction. *See Zepkin*, 812 F.2d at 152; *accord Pinter v. Dahl*, 486 U.S. 622, 642 (1988) (the language of Section 12(1) of the 1933 Act, imposing liability upon any person who "offers or sells a security" to a purchaser, "contemplates a buyer-seller relationship not unlike contractual privity.")[5]

Such a restriction on standing under RICO is fully consistent with the will of Congress, as embodied in other provi-

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(continued footnote)

of Civil RICO in Securities Litigation, 65 NOTRE DAME L. REV. 896, 947 n.288 (1990) (hereinafter "*RICO in Securities Litigation*").

5 One commentator has noted: "If the statutory interpretation argument in *Blue Chip* is then applied, standing under section 1961(1)(D) would be restricted to buyers of securities alone." MacIntosh, *RICO: Powerful New Tool*, 31 KAN. L. REV. at 35 (footnote omitted). The weight of authority, however, suggests that 18 U.S.C. § 1961(1)(D) also reaches fraud in the purchase of securities. *See* L. Loss, FUNDAMENTALS OF SECURITIES REGULATION 711 n.43 (1988) (citing *Lickhalter v. System Dev. Corp.*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,459 (C.D. Cal. Mar. 20, 1984)); *see also* Note, *Application of the Racketeer Influenced and Corrupt Organizations Act (RICO) to Securities Violations*, 8 J. CORP. L. 411, 430-31 (1983); J. Rakoff & H. Goldstein, *RICO: Civil and Criminal Law and Strategy* § 2.02[2] (1990); Mathews, *RICO in Securities Litigation*, 65 NOTRE DAME L. REV. at 945 n.273 (collecting cases).

sions of the 1933 Act and 1934 Act which confer express rights of action. By extending standing to non-purchasers and non-sellers, the Court below has improperly expanded the plaintiff class under RICO even beyond the bounds Congress delineated for comparable *express* rights of action. *See Blue Chip Stamps*, 421 U.S. at 736; Mathews, *RICO in Securities Litigation*, 65 NOTRE DAME L. REV. 896, 902-26 (1990). In reaching its conclusion, the Court below failed to give effect to *Blue Chip Stamps* on the ground that the purchaser/seller requirement was established by the Court in the context of construing an implied cause of action under Section 10(b) and Rule 10b-5. The decision below misapprehends the genesis of the rule of *Blue Chip Stamps*.

The outcome of *Blue Chip Stamps* was not contingent upon the implied nature of the right of action construed, but rather, the limitations inherent in the language of the provisions before the Court. *Blue Chip Stamps*, 421 U.S. at 731, 737; 421 U.S. at 755 (Powell, J., concurring); *see Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463-464 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); *Ernst & Ernst v. Hochfelder*, 425 U.S. at 200-01 ("Where, as here, we deal with a judicially implied liability, the statutory language certainly is no less important."). The Court's emphasis on statutory language in *Blue Chip Stamps* is well noted. Ruder, *Judicial Developments Under Rule 10b-5: Standing, Scienter, Reliance, Materiality and Implied Rights of Action*, 7TH ANN. INST. ON SEC. REG. 303, 313-14 (P.L.I. 1976). In concluding that *Blue Chip Stamps* was entitled to something less than deference in the RICO context, the Court below simply failed to acknowledge the *ratio decidendi* of *Blue Chip Stamps*, or apply the "plain language" of Section 1961(1)(D) as written. *See Sedima*, 473 U.S. at 495 n.13. Had the Ninth Circuit employed the proper statutory analysis, the conclusion would have been inescapable that a purchaser/seller standing requirement exists under 18 U.S.C. § 1961(1)(D).

In reaching the opposite result, the decision below effectively repeals by implication a half-century of jurisprudence which has invested the federal securities law with clear mean-

ing. *Zepkin* 812 F.2d at 152-53. In applying those statutes, this Court has held: " '[i]t is, of course, a cardinal principle of statutory construction that repeals by implication are not favored.' " *Randall v. Loftsgaarden*, 478 U.S. 647, 661 (1986) (citation omitted). This principle has particular force where, as here, a general statute operates to repeal a more specific one. *United States v. United Continental Tuna Corp.*, 425 U.S. 164, 168 (1976). By permitting a plaintiff to evade the purchaser/seller requirement at will, the Court below has rendered long-settled restrictions in securities fraud cases ineffectual, and nullified the specific Congressional policies those restrictions implement.

To expand the plaintiff class in the manner allowed by the Court below, would allow civil RICO to disrupt or displace decades of statutory and judicial development of civil remedies under the federal securities laws. *Sedima*, 473 U.S. at 504, 505 (Marshall, J., dissenting). That development has recognized the importance of the integrated statutory scheme to its proper interpretation and enforcement. "The 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 206. This Court has often recognized the elaborate and careful calculus of these statutes in giving meaning to their provisions. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. at 206 (citing *SEC v. National Sec., Inc.*, 393 U.S. 453, 466 (1969)); *Blue Chip Stamps*, 421 U.S. at 727-30; *Touche Ross & Co. v. Redington*, 442 U.S. 560, 571-73 (1979); *Aaron v. SEC*, 446 U.S. 680, 695 (1980). All this would be swept away if the interpretation below were to prevail, and the carefully articulated balance of policy concerns crafted by Congress would be destroyed.

As the Securities and Exchange Commission itself has recognized, this result is neither correct nor sound. It has expressed concern that the civil liability provisions of RICO operate in many cases to "convert otherwise untenable routine private securities fraud claims into RICO claims" thereby exposing defendants to extraordinary liability not available under the securities laws themselves. *See Statement*

of Mary L. Schapiro, Comm'r, SEC, Concerning RICO Amendments Act of 1991: Hearing on H.R. 1717 Before the Subcomm. on Intellectual Property and Judicial Administration of the House Judiciary Comm., quoted in 6 Civil RICO Report, at 1-2 (Apr. 30, 1991). Thus, the SEC has recognized that RICO, as applied by certain courts, has "undermine[d] the balanced structure that has developed under the federal securities laws" and such "distortion imposes substantial costs on corporate issuers and securities firms." *Id.*

Addressing a similar issue, Justice John Marshall Harlan provided this guidance as to how a general provision of securities law should interact with preexisting, specific federal securities laws:

> Courts and commentators have long debated whether Rule 10b-5 should be read as a sweeping prohibition against fraud in the securities industries when this results in rendering nullities of the other antifraud provisions of more limited scope which can be found in the statute books. The late Judge Jerome Frank, Professor Louis Loss and Milton Cohen,—to mention only three of those particularly eminent in this field—have warned that Rule 10b-5 should not be construed to supersede the special statutory schemes which Congress has devised to assure fair dealing in various aspects of the securities business.

SEC v. National Sec., Inc., 393 U.S. 453, 470 (1969) (Harlan, J., concurring) (citations & footnotes omitted); *see also* AICPA, *The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed*, AICPA White Paper on Civil RICO, at 44-45 (Oct. 10, 1984), *quoted in Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law* 24 (Mar. 28, 1985).[6]

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6 Additionally, it should be noted that Section 1961(1)(d) defines predicate acts that may be the subject of criminal, as well as civil adjudica-

(footnote continued)

B. SIPC Was Not Injured By Reason Of Fraud In The Sale Of Securities.

In deciding that the SIPC had standing to sue under RICO, the Court below commenced and concluded its analysis of the issue by referring solely to the broad language of 18 U.S.C. § 1964(c). A private right of action is provided under RICO to "[a]ny person injured in *his* business or property *by reason of* a violation of Section 1962." 18 U.S.C. § 1964(c). The phrase "by reason of" imposes a proximate cause requirement upon private plaintiffs. *Haroco, Inc. v. American Nat'l Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985) (per curiam). " '[A] defendant who violates section 1962 [of RICO] is not liable for treble damages to everyone he might have injured by other conduct, nor is the defendant liable to those who have not been injured.' " *Sedima*, 473 U.S. at 496-97 (quoting *Haroco*, 747 F.2d at 398). Thus, any recoverable damages occurring by reason of a violation of Section 1962 "will flow from the commission of the predicate acts." *Id.*

In order to sustain its right of action under RICO, the SIPC was required to establish that its injury was caused by reason of the "fraud in the sale of securities." 18 U.S.C. §§ 1961(1)(D), 1964(c). The ambit of persons who can claim to have sustained judicially cognizable injury from such securities transaction has already been determined by this Court in *Blue Chip Stamps*, 421 U.S. at 733-736. The statutory and policy rationale of that case is equally applicable here, and the language of Section 1964(c) should be interpreted *in pari materia* with the nexus prescribed by Section 10(b). Consequently, whether viewed as a "bystander[ ] to the securities marketing process," *Blue Chip Stamps*, 421 U.S. at 747, or

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(continued footnote)

tion. The purchaser/seller requirement may be imposed in the context of a private action for damages, without necessarily imposing a similar requirement upon the government in a criminal prosecution of the same conduct under the same law. *See United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979).

as an indirectly injured party, *Zepkin*, 812 F.2d at 153, SIPC did not incur its injury by reason of a fraud in the sale of securities, and therefore lacks standing under RICO.

POINT II

THE DECISION BELOW IMPOSES POTENTIAL LIABILITY OF INDETERMINATE SCOPE TO AN INFINITE CLASS OF PLAINTIFFS IN DEROGATION OF SETTLED PUBLIC POLICY.

Over the last generation, there have been numerous attempts by plaintiffs to expand liability under the federal securities laws beyond their legislatively-defined scope. These efforts have been largely unsuccessful. *See, e.g., Blue Chip Stamps*, 421 U.S. 723; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (scienter must be established in a private action for damages under Section 10(b) of the 1934 Act); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (breaches of fiduciary duty in connection with corporate mergers are not actionable under Section 10(b) and Rule 10b-5).

These decisions reflect the basic policy considerations that civil liability should be defined by the words of the statute, read in their context, and must be confined within reasonably manageable bounds. *Blue Chip Stamps*, 421 U.S. at 739-49; *Ernst & Ernst v. Hochfelder*, 425 U.S. at 214 n.33; *Santa Fe*, 430 U.S. at 478-79. The Court below, however, not only disregarded the language of Sections 1961(1)(D) and 1964(c), but it also failed to appreciate the grave policy concerns raised by its expansive view of RICO liability. These public policy concerns, therefore, bear emphasis and reaffirmation.

The Harm of Vexatious Litigation

Litigation under civil RICO, as manifested by the decision below, embodies the very evils that RICO was designed to combat. RICO has been used for "extortive purposes." *Sedima*, 473 U.S. at 506 (1985) (Marshall, J., dissenting);

Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law 69. The purchaser/seller requirement is designed, in part, to screen out "fraudulent suits." *Blue Chip Stamps* 421 U.S. at 761 n.5 (Powell, J., concurring). The decision below creates irresistable incentives for private plaintiffs, in their unfettered discretion, to use extortive and fraudulent litigation to exact lucrative settlements. In a very real sense, the cure has become the disease.

The dynamics of the "strike" suit underscore the point. One class action attorney, arguing for expansive liability, has stated: " 'Someone has to pay when a person . . . invests in a company that goes sour.' " Berton, *Investors Call CPAs To Account*, Wall St. J., Jan. 28, 1985, at 30, col. 4. Employing this mind set, RICO cases can be built against legitimate businesses, including accounting firms, "on a scaffolding of the merest guesswork and supposition, junk science, and prejudicial tidbits." W. Olsen, THE LITIGATION EXPLOSION 289 (1991). It is therefore not surprising, but regrettable, that in the year subsequent to *Sedima* alone, "at least 22 RICO suits [had] been filed against small CPA firms who have AICPA insurance and at least 31 against larger firms, according to AICPA general counsel Donald Schneeman." Galen, *Litigation Blitz Hits Accountants*, Nat'l L.J., Jun. 16, 1986, at 27, col. 1.

The scope of liability under the securities law established in *Blue Chip Stamps* embodies a policy judgment of Congress, given effect by this Court, that excessive exposure to damage claims does "more harm than good." *Blue Chip Stamps*, 421 U.S. at 748. That judgment is equally applicable here. In particular, then Justice (now Chief Justice) Rehnquist identified the significant policy reasons justifying the purchaser/seller rule in his opinion for the Court in *Blue Chip Stamps*.

First, "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. Such litigation threatens an undue risk of abuse,

distortion of the securities market, large judgments ultimately payable by innocent investors, meritless "strike" suits with disproportionate settlement value, frustration or delay of normal business activity, extensive depositions and discovery of business documents, and the hazards of a liability in an indeterminate amount, for an indeterminate time, to an indeterminate class. *Id.* at 739-49 (citation omitted).

Second, the vexatious litigation that would arise would be marked by cases built upon oral testimony, uncorroborated by documentary or objective evidence, and not susceptible to pre-trial dismissal. An actual purchaser or seller would be capable of documenting and verifying the purchase or sale in most cases. In contrast, a person choosing *not* to purchase or sell securities would be dependent upon his or her own oral testimony—not an objectively demonstrable fact—which would need to be assessed by the jury. *Blue Chips Stamps*, 421 U.S. at 743-48. The potential for abuse and fraud, absent the purchaser/seller requirement, is manifest.

The same considerations that motivated this Court in *Blue Chip Stamps* to restrict the plaintiff class in securities fraud cases to purchasers and sellers should, *a fortiori*, compel the same result in this RICO action for treble damages and attorneys' fees.

Harm to the Accounting Profession

The continued, abusive expansion of RICO will harm the very entities the statute was designed to protect: legitimate businesses such as accounting firms. Since at least 1985, there has been virtual unanimity that "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors." *Sedima*, 473 U.S. at 500; 473 U.S. at 500-01 (Marshall, J., dissenting); 473 U.S. at 524-25 (Powell, J., dissenting); *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 255 (1989) (Scalia, J., concurring). The Court below has accelerated this evolution. If allowed to stand, the decision below will cause an explosion

of vexatious suits against legitimate businesses, such as accounting firms, seeking treble damages and attorneys' fees, commenced by strangers to the challenged commercial and securities transactions, which have heretofore been barred.

The evolution of RICO alluded to in *Sedima* has degenerated to the level of the absurd. As one editorial recently noted:

> Along with couples suing each other as racketeers in divorces, among the 1,000 or so cases filed in the past year are companies suing each other as racketeers for claims they made in pet-food advertisements and a California lawyer who sued the City of Huntington Beach as a criminal enterprise for giving him three speeding tickets. Scores of such cases are lured by the promise of triple damages and the opportunity to slander the other side with "racketeer."

Look Who's Saving RICO, Wall St. J., May 24, 1991, at A10, col. 1. This trend dramatically affects accountants. Accountants, like other potential defendants, have a great interest in stemming this "inexorable broadening of the class of plaintiff[s]" in fraud actions:

> In *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931), Chief Judge Cardozo observed with respect to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class":
>
> > "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences." *Id.*, at 179-180, 174 N.E., at 444.

Blue Chip Stamps, 421 U.S. at 747-48. The wisdom of *Ultramares*, as reaffirmed in *Blue Chip Stamps*, was simply not adequately considered by the Court below.

The threat thus imposed involves more than economic harm. As professionals, accountants and accounting firms depend for their livelihood on fostering a reputation for careful, high-quality work. *See DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990). The strike suits that would proliferate under the decision of the Court below can cause substantial harm to the reputation of an accounting firm, which is arguably its "most valuable economic asset." *O'Brien v. Price Waterhouse*, 740 F. Supp. 276, 280 (S.D.N.Y. 1990) (Leisure, J.). The purchaser/seller requirement enables the district court to evaluate claims against an objectively verifiable standard, and thereby protects the spectrum of defendants, including accountants, from reckless and unfounded public attacks upon their reputations. *Blue Chip Stamps*, *supra*. The decision below invites securities fraud claims, built upon uncorroborated oral assertions that may be advanced by the world at large, that may not be susceptible to dismissal before trial. *Blue Chip Stamps*, *supra*. This accords RICO claims enhanced *in terrorem* effect, inasmuch as it is often easier to settle a frivolous case than repair the damage inflicted when publicly branded a "racketeer."

The added threat of potentially indeterminate liability could in fact have the undesirable effect of limiting the availability of high-quality accounting services. In order to avert the possibility of crippling liability, many accountants would consider simply declining audits of enterprises they perceive as risks—the very enterprises as to whom the public could most benefit from a high-quality audit. *See generally* Minow, *Accountants' Liability and the Litigation Explosion*, J. Acct., Sept. 1984, at 70, 80; Siliciano, *Negligent Accounting and the Limits of Instrumental Tort Reform*, 86 MICH. L. REV. 1929, 1960-63 (1988). Larger firms may not wish to risk the damage to their reputations that could result from a deluge of RICO actions even if those suits were meritless, while smaller firms may often find that the expense of defending themselves against such a deluge could drive them out of business.

The unwarranted expansion of accountants' liability under RICO would chill the free flow of information in commercial relationships in additional ways. As recognized by the United States Court of Appeals for the Seventh Circuit, the improper extension of accountants' liability would increase the costs of accountancy services, and thereby diminish the accessibility to such services. *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990). Accountants play an integral role in the dissemination of financial information, a process at the core of the federal securities laws. *See* 1933 Act, 15 U.S.C. § 77aa (Schedule A) (25)-(27); and, 1934 Act, 15 U.S.C. § 78*l*(b)(1)(J)-(K). The decision below will only increase the initiation of litigation against accountants, with concomitant costs to the accounting profession, the investing public, and society.

The Disruption of the Capital Markets

This chilling effect upon the delivery of accountancy services also operates to impair the proper functioning of the capital markets. The capital markets, through which securities are traded and resources are allocated, function on the principle of "informational market efficiency." Jagannathan & Palfry, *Effects of Insider Trading Disclosures on Speculative Activity and Future Prices*, 27 ECON. INQUIRY 411, 427 (1989); *see Basic Inc. v. Levinson*, 485 U.S. 224, 245-47 (1988). In an efficient capital market, firms can make production and investment decisions, and investors can choose among securities that represent ownership of issuing firms, under the assumption that security prices at any time fully reflect all available information. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (May 1970). This has long been recognized. Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172 (1933). A rule of law that has as its inexorable consequence the diminution of information available to businesses and investors, and the disruption of the equilibrium of capital markets, embodies bad public policy.

Harms to Business and Competition

Blue Chip Stamps understood that "[t]he very pendency of the [securities fraud] lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Blue Chip Stamps*, 421 U.S. at 740 (citations omitted). This is also true in the context of RICO. The SEC has argued that the potential liabilities associated with civil RICO "impede capital formation" by issuers and may "discourage innovation by financial service providers," and thus, "put[ ] the United States at a competitive disadvantage by discouraging foreign involvement in our markets." 6 Civil RICO Report, *supra*, at 2. From a business perspective, the costs of RICO, as typified by decisions such as that of the Court below, are unquantifiable and unacceptable.

The Displacement of State Courts and State Law

RICO was not intended "to federalize common law claims in commercial disputes." Campbell, *Civil RICO Actions In Commercial Litigation: Racketeer or Businessman?*, 36 SW. L.J. 925, 950 (1982). Yet, the decision below has opened the doors of the federal courts to garden-variety civil fraud claims, far divorced from the influences of organized crime, that have traditionally been litigated in state courts. W.H. Rehnquist, *Remarks of the Chief Justice on Diversity Jurisdiction and Civil RICO*, 21 ST. MARY'S L.J. 5, 10-11 (1989); *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 255 (Scalia, J., concurring) (citation omitted). By permitting plaintiffs to assert under RICO securities fraud claims that otherwise would be barred from the federal courts, the decision below displaces state law and state courts, without serving any genuine federal interest. This frontal assault upon federalism, and the federal courts, is neither compelled nor warranted by the words of RICO or sound public policy.

The Threat to the Rule of Law

A civil liability system which compels private parties to settle actions, without regard for the merits of the claim or culpability involved, undermines the rule of law. If we are a nation of laws, with private relationships so ordered, the application of law to conduct to determine liability would seem elemental and indispensable. However, in the context of RICO and securities litigation, cases are brought with the sole aim to extract a settlement, and claims are often settled regardless of the merits. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 568-70 (1991). By eliminating one essential constraint upon strike suits, the Court below undermines the merit-based adjudication of grievances, and renders irrelevant the extensive body of securities law that operates as a shield in securities litigation.

CONCLUSION

For all of the foregoing reasons, the judgment of the Court of Appeals for the Ninth Circuit should be reversed, insofar as it reversed the order of the District Court.

Dated: June 6, 1991

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No. 90-727

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
Petitioner,
vs.
SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF SECURITIES AND COMMERCIAL LAW ATTORNEYS (NASCAT) IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Did the District Court err in granting summary judgment to Petitioner, Robert G. Holmes, Jr., when it held that Respondent, Securities Investor Protection Corporation, must be a "purchaser or seller" of securities in order to maintain an action under 18 U.S.C. §1964(c), which provides that "any person" may sue to recovery for an "injury to his business or property" which is "by reason of" any offense "involving fraud in the sale of securities . . . punishable under any law of the United States," mail fraud, or wire fraud carried out in violation of 18 U.S.C. §1962?

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INTEREST OF THE *AMICUS CURIAE*

The National Association of Securities and Commercial Law Attorneys (NASCAT), by counsel and pursuant to Rule 37.3 of this Court, hereby files its *amicus curiae* brief in support of Respondent, the Securities Investor Protection Corporation (SIPC). For the reasons set forth herein, NASCAT supports affirming the decision of the court below.

NASCAT is an association of nearly 500 attorneys who litigate antitrust, commercial, consumer and securities fraud class action and derivative cases in federal and state courts throughout the country. NASCAT and its members are devoted to representing victims of corporate abuse, fraudulent schemes and so-called "white-collar" criminal activity in cases that have the potential for advancing the state of the law, educating the public, modifying corporate behavior, and/or improving the access of victims to justice and compensation for the wrongs that have been inflicted upon them.

NASCAT's members have litigated (and are presently litigating) numerous treble damage civil actions arising under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§1961-1968. NASCAT has found civil RICO actions to be the only remedy that a wide range of the American people, ranging from small businesses to the elderly, have to obtain adequate redress when they are cheated by fraud or criminal behavior, including securities fraud schemes which, unfortunately, are rampant in today's society. In order to ensure that the access to justice and adequate compensation which Congress expressly provided in RICO's civil remedy provisions, 18 U.S.C. §1964, is neither narrowed nor foreclosed but, rather, is nurtured and interpreted in accordance with its remedial purpose, NASCAT believes that the decision of the court below should be affirmed and the standing limitation which Petitioner seeks to impose in civil RICO cases should be rejected.

ARGUMENT

A. PRIVATE CIVIL RICO ACTIONS ARE AN ESSENTIAL WEAPON IN SOCIETY'S ARSENAL OF REMEDIES AGAINST CRIMINAL AND FRAUDULENT ACTIVITY, INCLUDING SECURITIES AND CONSUMER FRAUD

We live today in a society whose landscape is littered by frequent, costly and life-threatening failures of financial institutions of catastrophic proportions, many of which have been caused by fraudulent and criminal activity.[1] The past twenty years have witnessed innumerable financial scandals of immense proportions, accompanied in some cases by criminal indictments, guilty pleas, trials and jail sentences and resulting in multi-billion dollar losses to innocent investors involving the infamous Drexel Burnham Lambert,

[1] The financial costs incurred by society as a result of fraudulent activity are enormous. In 1974, the United States Chamber of Commerce estimated that approximately $42 billion was lost to fraud per year. Chamber of Commerce of the U.S., *A Handbook on White Collar Crime: Everyone's Problem, Everyone's Loss* 6 (1974). A decade later, the Attorney General of the United States observed that white-collar crime, principally fraud, costs society nearly $200 *billion* annually. 1985 Att'y Gen. Ann. Rep. 42; *see also White Collar Crime: Hearing Before the Senate Committee on the Judiciary*, 99th Cong., 2d Sess. Parts I-III (1985). That now-dated annual loss figure is similar in dimensions to our nation's drug problem, which is most often described as an epidemic. *See, e.g., Drug Enforcement: Hearings on H.R. 526 Before Subcommittee on Crime of the House Committee on the Judiciary*, 99th Cong., 2d Sess. 1 (1986) (remarks of Rep. William J. Hughes) ($110 billion spent annually on drugs while lost productivity costs approximately $60 billion); *The Cost of Drug Abuse, $60 Billion a Year*, N.Y. Times, Dec. 5, 1989, at D1, col. 1 (stating that the "cost of illicit drugs to American society [is] far more than $60 billion annually").

Inc.[2] and its junk bond guru, Michael R. Milken,[3] as well as other Wall Street investment banks and brokerage houses[4] and so-called "financiers" including Ivan F. Boesky[5] and

[2] The highest-flying investment banking firm of the 1980's, Drexel pled guilty to federal felony securities fraud charges and paid $650 million in fines and sanctions, *see SEC v. Drexel Burnham Lambert, Inc.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93,999 (S.D.N.Y. Sept. 7, 1988) (filing of enforcement action); *SEC v. Drexel Burnham Lambert, Inc.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,474 (S.D.N.Y. June 20, 1989) (entry of consent decree); Cohen, *With Signed Checks, Formal Guilty Plea, Drexel Ends Ordeal*, Wall St. J., Sept. 12, 1989, at A3, col. 4 (Drexel's guilty plea to criminal charges), while its subsequent and costly bankruptcy is still being resolved.

[3] Milken, the most notorious "financier" of the 1980's and possibly the foremost financial criminal mastermind since the equally infamous Charles Ponzi, *see generally* D. Dunn, *Ponzi, The Boston Swindler* 247-48 (1975), was indicted on 98 counts of RICO and criminal securities fraud, pled guilty to six counts and was recently sentenced to ten years' imprisonment. *See "Junk Bond" Leader Is Indicted by U.S. in Criminal Action*, N.Y. Times, Mar. 30, 1989, at A1, col. 6 (reporting 98-count indictment against Milken); *SEC v. Milken*, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,200 (S.D.N.Y. Apr. 24, 1990) (settlement of civil enforcement action against and guilty plea by Milken); Cohen, *Milken Pleads Guilty to Six Felony Counts*, Wall St. J., April 25, 1990, at A12, col. 6 (reporting guilty plea); *United States v. Milken*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶95,770 (S.D.N.Y. Nov. 23, 1990) (detailing findings of Milken's wrongdoing from *Fatico* hearing).

[4] The inside trading and other scandals which rocked Wall Street in the 1980's also trapped Kidder Peabody & Co., *see* N.Y. Times, June 5, 1987, at 1, col. 2 (Kidder, Peabody pays $25.3 million to settle insider trading charges), while E.F. Hutton & Co. also acknowledged systemic criminal behavior, *see Why the E.F. Hutton Scandal May Be Far From Over*, Bus. Wk., Feb. 24, 1986, at 98, col. 1 (E.F. Hutton pleads guilty to 2,000 counts of mail and wire fraud in multi-million dollar bank scam); *see also White Collar Crime (E.F. Hutton): Hearings Before the Senate Judiciary Committee*, 98th Cong., 2d Sess. 132 (1986) (Sen. Joseph R. Biden: "Where I come from that is called 'theft.' " Robert Foman, chairman of E.F. Hutton Group, Inc.: "It is probably not different").

[5] The Wall Street inside trading scandal resulted in the indictments, guilty pleas and/or trials, and criminal sentencing of some of Wall Street's most prominent investment bankers and traders, including arbitrageur Ivan F. Boesky, *see SEC v. Boesky*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶92,991 (S.D.N.Y. Nov. 14, 1986) (Boesky's consent to entry of

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Dennis Levine,[6] the savings and loan (or ironically named "thrift") industry,[7] procurement scandals involving defense

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permanent injunction); *N.Y. Times*, Apr. 24, 1987, at 29, col. 6 (reporting Boesky guilty plea); 133 Cong. Rec. H8841 (daily ed. Oct. 20, 1987) (remarks of Rep. John Conyers) (discussing securities fraud, including a detailed analysis of many of the mergers and alleged inside trading involving Boesky); *United States v. Boesky*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,417 (S.D.N.Y. Apr. 26, 1989) (reduction in Boesky's sentence as a result of his cooperation with prosecutors).

[6] The downfall of celebrated Drexel deal-maker and inside trader Dennis Levine has been well documented. *See SEC v. Levine*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶92,717 (S.D.N.Y. May 12, 1986) (filing of SEC enforcement action); *SEC v. Levine*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶92,761 (S.D.N.Y. June 5, 1986) (Levine's consent to entry of injunction); *SEC v. Levine*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,534 (2d Cir. Aug. 2, 1989) (tracing enforcement action against Levine); D. Frantz, *Levine & Co.: Wall Street's Insider Trading Scandal* (1987) (recounting the investigation and prosecution of Levine, Martin Siegel and Boesky); M. Stevens, *The Insiders: The Truth Behind the Scandal Rocking Wall Street* (1987) (telling the story of Levine's investigation and prosecution).

[7] Numerous shareholder and derivative suits have been brought by the Resolution Trust Corporation (RTC), creditors and innocent investors (including shareholders and bondholders) against the owners, operators, insiders, professional advisers and affiliates of numerous savings and loan institutions which failed as a result of insider abuse, engaging in fraudulent transactions and ill-advised and excessive "direct" investments, including the purchase of billions of dollars of "junk bonds" peddled by Drexel/Milken. *See* Note, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis?*, 64 Notre Dame L. Rev. 222 (1989); J. Adams, *The Big Fix: Inside the S&L Scandal* (1990); S. Pizzo, M. Fricker & P. Muolo, *Inside Job: The Looting of America's Savings and Loans* (1989). President Bush told the nation that "unconscionable risk-taking, fraud, and outright criminality [were] factors" that led to the savings and loan crisis. Dowd, *Bush Savings Plan Calls for Shaving the Cost Broadly*, N.Y. Times, Feb. 7, 1989, at D9, col. 1. Congressional and other Government studies support the President's harsh judgment, concluding that at least one-third of all bank failures and three-quarters of thrift failures involve the criminal activity of insiders. *See* H.R. Rep. No. 1088, 100th Cong., 2d Sess. 2-13 (1988) (stating that criminal misconduct by insiders is a major contributing factor in approximately one-third of all commercial bank failures and three-fourths of all thrift failures); Office of Comptroller of the Currency,
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contractors,[8] the recent failure of pension funds and insurance companies,[9] as well as less publicized (but certainly no

(fn. continued)
Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks 9 (1988) (finding that insider abuse is a significant factor in 35% of all commercial bank failures).

[8] Since 1988, when the Justice Department's Operation Ill Wind began operation, numerous defense contractors, their employees and Beltway "consultants" have pled guilty to federal criminal charges stemming from bribery of government officials to secure inside information about pending defense contracts. *See* Lewis, *Ex-Naval Official Makes Guilty Plea In Bid-Rigging Case*, N.Y. Times, June 15, 1991, at A-1, col. 4 (announcing former senior Pentagon official's guilty plea to federal conspiracy and bribery charges and noting that "[w]ith [Melvyn R.] Paisley's plea, 41 individuals and 5 corporations had pleaded guilty to charges that have portrayed a flourishing system involving consultants, usually former Pentagon officials, selling information gained from former colleagues in the Government to contractors"); Pasztor, *Unisys Agrees To Settlement In Ill Wind Case*, Wall St. J., June 10, 1991, at A-3, col. 1 (announcing Unisys' agreement to pay $190 million to settle criminal charges arising out of Ill Wind investigation); Pasztor, *Prosecutors Close in on Unisys, Other Contractors As Arms-Procurement Inquiry Gains Momentum*, Wall St. J., Jan. 8, 1990, at A14, col. 1 (providing a scorecard on Operation Ill Wind: Emerson Electric entered a guilty plea and agreed to a $2 million settlement; Teledyne, Inc. entered a guilty plea and agreed to an $8.3 million settlement; Whittaker Corp. entered a guilty plea and agreed to a $7 million settlement; and Loral Corp. entered a guilty plea and agreed to a $10.5 million settlement). Notable among these cases is Northrop Corporation's 1989 indictment and subsequent guilty plea to federal criminal charges. Northrop shareholders recently settled a civil RICO derivative suit accusing company officials of numerous episodes of criminal wrongdoing in the 1980's, including the payment of bribes in 1983-84 to South Korean government officials in an unsuccessful attempt to entice them to buy Northrop's ill-fated F-20 Tigershark fighter. *See Northrop Proposes $18 Million Settlement*, N.Y. Times, May 25, 1991, at 19, col. 1. Northrop, of course, is a recidivist offender, having pled guilty in the mid-1970's to similar charges arising out of the payments of bribes to foreign governments in order to secure contracts to sell fighter aircraft. *See* J. Noonan, *Bribes*, 656-657 (1984).

[9] The recent collapse and seizure of California-based insurers First Executive Corporation and First Capital Corporation stemming from their excessive investments in Drexel-underwritten and Milken-brokered junk bonds, *see* Berg, *Shielding Insurer From Its Parent*, N.Y. Times, June 1,
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less noteworthy) consumer fraud scandals[10] which occur with increasing frequency. The costs to our society[11] and

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1991, at 17, col. 4, has panicked their policyholders, many of whom are elderly. Unfortunately, the most recent insurance company collapses are but part of a trend which can only worsen because insurers improvidently purchased 30% of the junk bonds in the United States, while pension funds own another 15%. *See* Rosen, *Your Money: Are the Insurers Fiscally Strong?*, N.Y. Times, Jan. 6, 1990, at 34, col. 1. Congressional studies have pointed out clear parallels between the thrift crisis and the ripening insurer crisis. *See* Subcomm. on Oversight and Investigations of the House Committee on Energy and Commerce, 101st Cong., 2d Sess., *Failed Promises: Insurance Company Insolvencies* iii (Comm. Print 1990) (Chmn. John D. Dingell: "The parallels between the present situation in the insurance industry and the early stages of the savings and loan debacle are both obvious and deeply disturbing. They encompass scandalous mismanagement and rascality by certain persons entrusted with operating insurance companies, along with an appalling lack of regulatory controls to detect, prevent, and punish such activities").

[10] *See, e.g., Combs v. Bakker*, 886 F.2d 673 (4th Cir. 1989) (reinstating civil RICO suit against fallen evangelist Jim Bakker and his associates for fraudulently selling 55,000 "lifetime" partnerships in his ministry); Gottschalk, *Churchgoers Are the Prey As Scams Rise*, Wall St. J., Aug. 7, 1989, at C1, col. 3 (reporting that "[m]ore than 15,000 Americans lost a total of $450 million in five years of bogus money-making schemes promoted by religious charlatans," according to the North American Securities Administrators Association and the Council of Better Business Bureaus); *Guilty Plea by Ex-Officer of Beech-Nut*, N.Y. Times, Nov. 14, 1989, at D1, col. 6 (reporting that the president of Beech-Nut Nutrition Corp. pled guilty to selling sugar water as apple juice for babies to consumers).

[11] For example, to deal with the savings and loan crisis Congress enacted special legislation, estimated to cost as much as $500 *billion* over thirty years, to rescue more than 350 troubled thrifts. *See* Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989) (FIRREA) (amending scattered sections of 12 U.S.C.); Quint, *New Estimate on Savings Bailout Says Cost Could Be $500 Billion*, N.Y. Times, Apr. 7, 1990, at A1, col. 1 (reporting estimates of General Accounting Office over 30-year period). In fact, the cost of the savings and loan bailout cannot presently be estimated. Labaton, *New Finance Woe: F.D.I.C. Loss Worse; S&L Crisis Deeper*, N.Y. Times, June 11, 1991, at A-1, col. 1.

legal system[12] and the concomitant loss of investor confidence in public institutions, most notably the securities markets, cannot be accurately measured.[13] Similarly, the

[12] Pending cases seeking redress for fraudulent activity in the "thrift" industry have been brought by the Federal Deposit Insurance Corporation (FDIC) and the RTC, as well as innocent investors who have been tragically defrauded of their life's savings, including such pending civil RICO actions as *In re American Continental Corporation/Lincoln Savings & Loan Securities Litigation*, MDL Docket No. 834 (D. Ariz. pending), where the RTC and nearly 23,000 elderly Southern California residents jointly seek to recover damages of $500 million, the fruits of an elaborate securities fraud scheme masterminded by notorious thrift looter Charles H. Keating, Jr., who utilized political influence to hold off regulatory censure or seizure of Lincoln Savings (through such means as improperly influencing members of Congress, including "the Keating Five") while he peddled worthless junk bonds in Lincoln's branches to specifically targeted elderly victims who thought they were purchasing government-insured subordinated debentures. The *ACC/Lincoln Savings* class action, which targets three "national" accounting firms (Arthur Andersen & Company, Arthur Young & Company and Touche Ross & Company) and so-called "reputable" law firms (including Jones, Day, Reavis & Pogue) who aided and abetted Keating's fraudulent scheme, and a companion suit brought by the RTC will go to trial in January, 1992.

[13] When Michael R. Milken was indicated, acting United States Attorney Benito Romano observed that "[t]he three-year investigation has uncovered substantial fraud in a very significant segment of the American financial community. A serious criminal problem has infected Wall Street." *"Junk Bond" Leader Is Indicted by U.S. in Criminal Action*, N.Y. Times, Mar. 30, 1989, at A1, col. 6. According to one commentator, the essence of the Government's charges against Milken was his betrayal of his fiduciary obligations to Drexel's clients. Stein, *Betrayer of Capitalism: That Is the Essence of the Government's Charges Against Milken*, Barron's, Apr. 3, 1989, at 7. Trust is the most important element in the free enterprise system and the stock market operates well only when investors have confidence in its integrity. *See* Blakey & Perry, *An Analysis of the Myths That Bolster Efforts to Rewrite RICO and the Various Proposals for Reform: "Mother of God — Is This the End of RICO?"*, 43 Vand. L. Rev. 851, 917 (1990). As a result of the recent financial scandals, fewer than one-quarter of all Americans have confidence in banks, insurance companies, or stock brokers. Schwadel, *Consumer Trust: An Elusive Quarry*, Wall St. J., Sept. 20, 1989, at B1, col. 3. Since the October, 1987, stock market crash, small investors' faith in Wall Street has been steadily eroding, *see* Putka, *People Invest Little Faith in Wall Street*, Wall St. J.,

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inevitable and accompanying diminution in public confidence in the professionals who aided and abetted this crime wave, including members of the legal[14] and accounting professions,[15] cannot be estimated with any certainty;

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Sept. 25, 1989, at B1, col. 3, and individual households today own 58.5% of United States stocks compared with 82.2% in 1968, *see* Power, ***Small Investors Are Punier Than Many Think***, Wall St. J., Mar. 28, 1989, at C1, col. 3.

[14] In assessing the causes and impact of the savings and loan crisis, careful attention must be paid to the roles played by professionals — attorneys, accountants, loan brokers, appraisers and investment bankers — who abandoned their professional ethics and willfully joined the "chain of greed" which epitomized the "thrifts' " operations and eventual downfall. *See* Harris, ***The S&L Looters Who May Get Away***, Wall St. J., Feb. 12, 1990, at A12, col. 3 (noting the essential roles played by lawyers who " 'papered' the bogus transactions by drawing up the contracts, and accountants [who] either looked the other way or neglected to scour the institutions' books too carefully"); France, ***Savings & Loan Lawyers***, 77 A.B.A.J. 52 (May 1991) (observing that essential roles were played by attorneys who aided and abetted thrift institutions' criminal wrongdoing). Judge Stanley Sporkin, who tried one aspect of the litigation relating to the catastrophic failure of Lincoln Savings, highlighted in pointed language the role played by professionals who instigated and/or aided and abetted the fraudulent operations of now-failed thrift institutions. *See Lincoln Savings & Loan Ass'n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990) ("Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?")

[15] In reviewing the *amicus curiae* briefs filed in this case by members of the accounting profession, this Court should remain cognizant that running through each of the recent catastrophic scandals is the problem of fraudulent financial reporting, which often causes widespread consequences through a devastating ripple effect. Blakey & Perry, 43 Vand. L. Rev. at 903; *Report of the National Commission on Fraudulent Financial Reporting* 4 (1987). Since 1980, the major accounting firms, all of which piously claim their innocence from wrongdoing in the *amicus curiae* briefs before this Court, have paid millions of dollars to settle liability suits, *see* Wayne, ***Where Were the Accountants?***, N.Y. Times, Mar. 12, 1989, §3, at 1, col. 2 (reporting that Arthur Young & Co. paid undisclosed sums to settle lawsuits arising out of its role in the collapse of Penn Square Bank). Three "national" accounting firms — Arthur Young & Co., Arthur Andersen & Co. and Touche Ross & Co. — have been implicated in the Lincoln

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however, it certainly cannot be ignored.

Government agencies (including SIPC, the FDIC and the RTC), creditors, defrauded investors and injured consumers have had precious few weapons with which to combat this near-tidal wave of corporate criminal wrongdoing, fraudulent activity and resulting multi-billion dollar financial losses occurring over the past 20 years. Certainly one of the foremost weapons available, and one which defrauded private and government plaintiffs have not hesitated to use in the recent past, is the treble damage civil action provided in Section 1964(c) of RICO.[16]

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Savings scandal, *see The Lapses by Lincoln's Auditors*, N.Y. Times, Dec. 28, 1989, at D1, col. 4; Blakey & Perry, 43 Vand. L. Rev. at 888-889 n.108 (detailing allegations of wrongdoing against ACC/Lincoln's auditors, for which they face potential liability exceeding $1 billion), and they face additional litigation and other sanctions as a result of their savings and loan "audits." *See* Berton, ***Big Accounting Firms Face Ban in S&L Bailouts***, Wall St. J., Mar. 14, 1990, at A3, col. 1 (reporting that five of the top six accounting firms were banned by the RTC from doing new work for thrifts because of pending litigation for past faulty audits); Andrews, *U.S. Sues Ernst & Young on Savings Unit Audits*, N.Y. Times, Mar. 3, 1990, at 21, col. 5 (reporting FDIC's suit seeking to recover $560 million against Ernst & Young in connection with its audit of Western Savings Association of Dallas, Texas).

[16] Chapter 96 of Title 18 of the United States Code, 18 U.S.C. §§1961-1968 (1982 & Supp. X), the Racketeer Influenced and Corrupt Organizations Act, which is commonly referred to by the acronym "RICO," was added to Title 18 of the United States Code by Title IX of the Organized Crime Control Act of 1970. Pub. L. 91-452, 84 Stat. 941. RICO takes aim at "racketeering activity," which it defines as any act "chargeable" under severally generically described state criminal laws, any act "indictable" under numerous specific federal criminal provisions, including mail fraud, wire fraud and interstate transportation of stolen property, and any "offense" involving bankruptcy fraud, "fraud in the sale of securities," or drug-related activity that is "punishable" under federal law. 18 U.S.C. §1961(1). Section 1962, entitled "Prohibited Activities," outlaws the use of income derived from a "pattern of racketeering activity" to acquire an interest in, establish, or operate an enterprise engaged in or affecting interstate commerce; the acquisition or maintenance in any interest in or control of an enterprise through a pattern of racketeering activity; conducting or participating in the conduct of an enterprise through a pattern of

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If history teaches us anything,[17] the overwhelming presence of organized criminal and fraudulent activity in

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racketeering activity; and conspiring to violate any of these provisions. 18 U.S.C. §1962(a)-(d). Congress provided criminal penalties of imprisonment, fines and forfeiture for violation of these provisions. 18 U.S.C. §1963. In addition, it provided a far-reaching civil enforcement scheme in Section 1964, including express authorization for civil suits. *See* 18 U.S.C. §1964(c).

17 When assessing Petitioner's arguments concerning RICO's utility, this Court should note that the pervasiveness of criminal and fraudulent activity in American society was noted more than twenty years ago. Writing in 1967, President Johnson's Crime Commission (also known as the Katzenbach Commission), whose studies led to RICO's enactment three years later, made the following pertinent observations about the effects of fraud upon society and its citizens:

> Fraud is especially vicious when it attacks, as it so often does, the poor or those who live on the margin of poverty. Expensive nostrums for incurable diseases, home improvement frauds, frauds involving the sale or repair of cars and other criminal schemes create losses which are not only sizeable in gross but are also significant and possibly devastating for individual victims.
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> During the last few centuries economic life has become vastly more complex. Individual families or groups of families are not self-sufficient; they rely for the basic necessities of life on thousands or even millions of different people, each with a specialized function, many of whom live hundreds or thousands of miles away.

President's Commission on Law Enforcement and Administration of Justice, *The Challenge of Crime in a Free Society* 33-34, 47-48 (1967).

Those who would seek to "reform" RICO or limit the broad reach which Congress intended at the time of its enactment in 1970 are reminiscent of those special interests who sought to emasculate the federal securities laws after their enactment in the early 1930's. As part of President Roosevelt's much-needed New Deal, Congress enacted legislation to deal with securities fraud, precisely because state fraud law was deemed inadequate to deal with "racketeering" on Wall Street. *See, e.g.*, 77 Cong. Rec. 3801 (1933) (remarks of Sen. Duncan Fletcher, leading sponsor of the Securities Act of 1933) ("[The Securities Act is] designed to protect the public from financial racketeering of ... investment bankers. . . ."). Similar to our experience in today's world, which has witnessed a literal Crusade of

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American society and business which led to RICO's enactment in 1970 have not abated; if anything, they have worsened in recent years,[18] and state law jurisprudence has continually proved ineffective to combat, much less deter, such wrongdoing.[19] Given these uncontested trends, it would be unconscionable to impose *any* limitation on RICO.

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special interest groups trooping to Capitol Hill seeking to "reform" RICO, the special interests of the 1930's repeatedly sought to repeal or modify the Securities Act, suggesting that the legislation was so "draconian" that it would "dry up the nation's underwriting business and that 'grass would grow on Wall Street.' " D. Ratner, *Securities Regulation in a Nutshell*, §11, at 80 (2d ed. 1982). History has proven the value of the Securities Act, along with the Securities Exchange Act of 1934, in policing the securities marketplace. The history of civil RICO, which is being written in numerous pending actions (including *ACC/Lincoln*) where defrauded investors seek redress against organized criminal and fraudulent activity, will also prove the value of this remedial statute.

18 The Chief Justice has stated that "[w]hite-collar crime is 'the most serious and all-pervasive crime problem in America today.' " *Braswell v. United States*, 487 U.S. 99, 115 n.9 (1988) (quoting Conyers, *Corporate and White-Collar Crime: A View by the Chairman of the House Subcommittee on Crime*, 17 Am. Crim. L. Rev. 287, 288 (1980)). The Chief Justice added, "Although this statement was made [by Representative Conyers] in 1980, there is no reason to think the problem has diminished in the meantime." *Id.* Indeed, a substantial body of literature demonstrates the continuing prevalence of white collar crime in corporate America. *See, e.g.*, Ross, *How Lawless Are Big Companies*, Fortune, Dec. 1, 1980, at 57 (1,043 major corporations indicated between 1970 and 1980: 117 convictions or consent decrees for 98 antitrust violations; 18 kickbacks, briberies, or illegal rebates; 21 illegal political contributions; 11 frauds; and five tax evasions). Given the experience of Wall Street alone in the recent past, it cannot be seriously contended that these figures would be smaller for the greed-riddled 1980's.

19 When Congress enacted RICO in 1970, it was because it found 18th and 19th century jurisprudence ineffective to combat fraud, as clearly demonstrated by the Statement of Findings enumerated as a preface to the Organized Crime Control Act of 1970, *see* 84 Stat. 923 (observing that existing "sanctions and remedies . . . [were] unnecessarily limited in scope and impact"); *see also United States v. Turkette*, 452 U.S. 576, 586 (1981) (Congress's view in enacting the statute "was that existing law, state and federal, was not adequate to address the problem, which was of national dimensions").

The rampant abuse of the public securities markets which the recent scandals, indictments, guilty pleas and/or criminal proceedings evidence demonstrate that the limitation on the statute which Petitioner champions would be especially damaging to the interests of innocent investors who are victimized in securities fraud schemes.

Although Petitioner and various *amicus curiae* who support his position contend that defrauded investors can secure adequate relief through claims brought under the federal securities laws, NASCAT's experience has been quite different. Indeed, the factual scenario which was recently before this Court in *Tafflin v. Levitt*, 865 F.2d 595 (4th Cir. 1989), *aff'd*, 110 S. Ct. 792 (1990), illustrates the point. In *Tafflin*, litigation that grew out of the catastrophic failure of Old Court Savings & Loan in Maryland, depositors sued for damages under the federal securities statutes and RICO. The Fourth Circuit, however, held that the "certificates of deposit" which plaintiffs had purchased were not "securities" under this Court's decision in *Marine Bank v. Weaver*, 455 U.S. 551 (1982). The Fourth Circuit then "abstained" on the civil RICO claim and remanded it to state court. *Tafflin v. Levitt*, 865 F.2d at 599-600. In that situation, the federal securities laws provided no haven to defrauded investors.

In an effort to avoid such tragic results, pending cases brought by government agencies (including SIPC, the FDIC and the RTC)[20] and the innocent investors whom RICO was

[20] Consistent with the President's pledge that lost funds would be restored and perpetrators punished, *see President's News Conference on Savings Crisis and Nominees*, N.Y. Times, Feb. 7, 1989, at D8, col. 1 (President Bush promises "every effort to recover losses diverted from these institutions and to place behind bars those who had caused losses through criminal behavior"), the Government is bringing criminal RICO prosecutions and the FDIC and FSLIC (now the RTC) are using RICO to sue banks and thrift fraud perpetrators, *see, e.g., In re American Continental Corp./ Lincoln Savings & Loan Securities Litigation*, MDL Docket No. 834 (D. Ariz. pending) (RTC prosecuting civil suit against Keating and his cohorts under federal and Arizona RICO statutes); *U.S. Regulators Sue Owners in*
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expressly enacted to protect illustrate the importance of its remedial provisions, which offer the potential recovery of treble damages and reasonable attorneys' fees to persons victimized by statutory violations. *See* 18 U.S.C. §1964(c). As set forth below, this Court has repeatedly and justly recognized that RICO's remedial provisions were expressly designed to encourage civil enforcement of its racketeering prohibitions. Given the inadequate prosecutorial resources available[21] to combat "white-collar" crime and fraud which

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Big Savings Unit Failure, N.Y. Times, Sept. 16, 1989, at 33, col. 1 (reporting filing of RTC's suit against Keating, *et al.* and allegation that collapse of Lincoln Savings would cost the taxpayers more than $2 *billion*).

[21] Fifty years ago, Justice Jackson observed that the criminal law has "long proved futile to reach the subtler kinds of fraud at all, and [is] able to reach grosser fraud, only rarely." R. Jackson, *The Struggle for Judicial Supremacy* 152 (1941). History has proven the wisdom of his words. It is doubtful that public agencies will ever be funded at adequate levels to carry out their oversight and prosecutorial responsibilities. *See* Labaton, *The S.E.C.'s Top Cop Moves On*, N.Y. Times, May 21, 1989, §3, at 1, col. 2 (reporting the resignation of SEC enforcement director Gary Lynch and evaluating the agency's efforts: of 650 people employed in Washington, D.C., and nine regional offices, 15% of the resources are devoted to insider trading, 15% to 20% to market manipulations, 25% to improper disclosure, and the rest to other problems); Sontag, *"Desperate" SEC Seeks More Aid*, Nat'l L. J., May 1, 1989, at 1, col. 4, (analyzing the size of the securities markets, the number of transactions, dealers and staff resources over the previous ten years and stating that the "agency [is] becom[ing] dangerously unable to keep pace"); *Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations for 1990: Hearings Before a Subcomm. of the House Comm. on Appropriations*, 101st Cong., 1st Sess., pt. 6, at 173 (1989) (Statement of David S. Ruder, chairman of the SEC, requesting an increase from the $135 million appropriated in 1988 and the $143 million estimated in 1989 to $169 million for 1990); at 208-09 (reporting that investor complaints, "which have increased significantly in recent years . . . are a traditional indicator of potential fraud. In 1987, the [SEC] received over 40,000 complaints and inquiries from investors, over 230% the number received in 1982").

are rampant in our society,[22] civil RICO has been (and remains) a tool of critical importance. Its use cannot — and should not — be inhibited or otherwise limited in securities fraud or consumer fraud cases. For the reasons stated herein, we respectfully urge this Court to affirm the decision of the Ninth Circuit and to reject the unjust limitation on RICO's deliberately broad reach sought by Petitioner.

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[22] Whether one speaks of "white-collar" crime, "organized" crime, or fraud, one refers to the same pervasive horror which has been inflicted upon our society. Writing in 1967, the Katzenbach Commission, whose studies led to RICO's proposal and enactment a few years later, noted the broad definition applicable to so-called "white collar" and "organized" crime, as well as the impact upon society when such wrongdoing goes unpunished:

> [W]hite-collar crime [is] — a term now commonly used to designate those occupational crimes committed in the course of their work by persons of high status and social repute [that] . . . are only rarely dealt with through the full force of criminal sanctions. . . . Serious erosion of morals accompanies [the white collar offender's] violation. [Those who so] flout the law set an example for other businesses and influence individuals, particularly young people, to commit other kinds of crime on the ground that everybody is taking what he can get.

President's Commission on Law Enforcement and Administration of Justice, *The Challenge of Crime in a Free Society* 47-48 (1967). Unfortunately, this pattern of lawlessness has been present throughout much of modern history and it shows no sign of abating. Writing in the early days of this century, Louis Brandeis prophetically stated, "The goose that lays the golden eggs has been considered a most valuable possession. But even more profitable is the privilege of taking the golden eggs laid by someone else's goose." L. Brandeis, *Other People's Money* 17-18 (1914).

B. REFERENCE TO RICO'S STATUTORY LANGUAGE, INCLUDING THE STATUTE'S LIBERAL CONSTRUCTION CLAUSE, DEMONSTRATES THAT CONGRESS INTENDED RICO TO BE AN EFFECTIVE WEAPON AGAINST FRAUDULENT ACTIVITY OF ALL KINDS, INCLUDING SECURITIES AND CONSUMER FRAUD

Reference to RICO's statutory language (including its liberal construction clause),[23] its legislative history and the decisions of this Court in previous civil and criminal RICO cases lead to the unavoidable conclusion that the statute must be broadly and liberally construed to effectuate a paramount public policy: the eradication of organized criminal[24] and

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[23] Section 904(a) of RICO, 84 Stat. 947, directs that "[t]he provisions of this Title shall be liberally construed to effectuate its remedial purposes." As this Court noted in *Russello v. United States*, 464 U.S. 16, 27 (1983), RICO is the "only substantive federal criminal statute that contains such a directive." For commentary on RICO's liberal construction clause, *see* Note, *RICO and the Liberal Construction Clause*, 66 Cornell L. Rev. 167 (1980); Note, *Liberal Construction of Title IX of the Organized Crime Control Act of 1970: Section 904(a) v. The Doctrine of Strict Construction*, 12 Rutgers L. J. 69 (1980). In addition, the Senate and House Reports accompanying RICO expressly stated that Section 1962(c)'s prohibitions are without limitation or exception. *See* Organized Crime Control Act of 1969, S. Rep. No. 617, 91st Cong., 1st Sess. 159 (1969); H.R. Rep. No. 1549, 91st Cong., 2d Sess. 4033 (1970).

[24] As this Court has previously noted, RICO's "legislative history clearly demonstrates that . . . [it] was intended to provide new weapons of unprecedented scope for an assault upon organized crime and its economic roots." *Russello*, 464 U.S. at 28. Although the major purpose of Title IX was "to address the infiltration of legitimate business by organized crime," *Turkette*, 452 U.S. at 591, RICO was not limited to the prohibition of infiltration of legitimate organizations. *Id.* at 590. Nor does RICO apply only to organized crime in the classic "mobster" sense. *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495 (1985) ("not just mobsters"). Accordingly, this Court has justly resisted the blandishments of those like

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fraudulent[25] activity in each of its despicable manifestations.

There is no logical basis upon which RICO's express statutory language[26] and Congress's clearly expressed

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Petitioner who would seek to limit RICO's reach to "organized crime" in the traditional sense. Just two years ago, this Court rejected a full-court press from various *amici* aligned with the accounting profession, finding that their arguments for reading an organized crime limitation into RICO's "pattern" concept "finds no support in the Act's text, and is at odds with the tenor of its legislative history." *H.J., Inc. v. Northwestern Bell Telephone Co.*, 109 S. Ct. 2893, 2903 (1989). As this Court noted, Section 1961(1) of RICO, with its purposefully broad definition of "racketeering activity," acknowledges the "breakdown of the traditional conception of organized crime, and responds to a new situation in which persons engaged in long-term criminal activity often operate *wholly* within legitimate enterprises." Consequently, Congress drafted the statute "broadly enough to encompass a wide range of criminal activity, taking many different forms and likely to attract a broad array of perpetrators operating in many different ways." *Id.* at 2905 (emphasis in original).

25 While RICO may have been aimed at "organized crime," its use "as a weapon against 'white collar crime' . . . is not contrary to the intent of Congress but is in fact one of the 'benefits' Congress saw the Act as providing." *Papai v. Cremosnik*, 635 F. Supp. 1402, 1411 (N.D. Ill. 1986) (citation omitted). In the admirable (and oft-quoted) words of Judge Pratt of the Second Circuit:

> [Congress] provided no exception for businessmen, for white collar workers, for bankers, or for stockbrokers. If the conduct of such people can sometimes fairly be characterized as "garden variety fraud", we can only conclude that by the RICO statute Congress has provided an additional means to weed that "garden" of its fraud.
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> It seems almost too obvious to require statement, but fraud is fraud, whether it is committed by a hit man for organized crime or by the president of a Wall Street brokerage firm.

Furman v. Cirrito, 741 F.2d 524, 529 (2d Cir. 1984) (Pratt, J., dissenting). Given the experience on Wall Street in recent years, it would seem academic to compare the wrongdoing of investment bankers and inside traders with Mafia "wiseguys."

26 Section 1962 of RICO is enforced by private suits brought under Section 1964(c), which provides that "[a]ny person injured in his business or property by reason of a violation of section 1962" may sue. 18 U.S.C. §1964(c). The statutory definition of "person" includes "any individual or (continued)

legislative intent can be interpreted by this Court to support the restriction which is sought by Petitioner in this case. The issue before this Court concerns whether the purchaser-seller standing requirement imposed by the courts in actions brought under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1982), and SEC Rule 10b-5, 17 C.F.R. §240.10b-5 (1991), should apply to plaintiffs bringing civil RICO actions based (most often) upon predicate acts of mail fraud, wire fraud and "fraud in the sale of securities."

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entity capable of holding a legal or beneficial interest in property." *Id.* §1961(3). The plain language of the statute, therefore, does not impose the "purchaser or seller" limitation sought by Petitioner on "any person." *See Bankers Trust Co. v. Rhoades*, 859 F.2d 1096, 1100 (2d Cir. 1988), *cert. denied*, 109 S. Ct. 1642 (1989) (holding that there is "no special limitation on standing").

Congress explicitly stated the only limitations on civil recovery under RICO: the "person" must show that his "business or property" was "injured." *Ford Motor Co. v. Summit Motor Products, Inc.*, 930 F.2d 277, 285 (3d Cir. 1991). In addition, as this Court recognized, "the plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation. . . . But the statute requires no more than this." *Sedima*, 473 U.S. at 496-97; *see also Marshall & Ilsley Trust Co. v. Pate*, 819 F.2d 806, 809-10 (7th Cir. 1987) (holding that it is wrong to require a plaintiff to show more).

If Congress had intended to limit the class of persons entitled to sue to enforce RICO's remedial provisions, narrowing the definition of "person" was all it took to achieve that objective; in the words of this Court, Congress could have "narrowed the sweep of the definition by inserting a single word." *Turkette*, 452 U.S. at 581 (discussing the definition of "enterprise"). Indeed, the short answer to Petitioner's contention is that " 'Congress did not write the statute that way,' " *United States v. Monsanto*, 109 S. Ct. 2657, 2664 (1989) (holding that "all property" does not exclude funds for legal fees) (quoting *United States v. Naftalin*, 441 U.S. 768, 773 (1979)), and this Court has repeatedly rejected similar attempts to rewrite RICO. *See Northwestern Bell*, 109 S. Ct. at 2902-05 (holding that "pattern" is not limited to organized crime-type perpetrators); *Sedima*, 473 U.S. at 495 (holding that "any person" is not limited to "mobsters"); *Russello*, 464 U.S. at 21-22 (concluding that "any interest" is not limited to "interest in enterprise"); *Turkette*, 452 U.S. at 580-81 (holding that "any enterprise" is not limited to an "illegal enterprise").

Because the judiciary implied a private right of action in SEC Rule 10b-5, this Court saw fit to impose an implied standing rule in such cases. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 749 (1975). Section 1964(c)'s right of action, however, is express and any judicial limitation on its scope (such as an implied standing rule) would be inappropriate. As this Court expressly recognized in *Blue Chip Stamps*:

> [I]f Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability.

421 U.S. at 748. This reasoning was adopted by the court below; in the words of the Ninth Circuit in this case:

> With regard to the RICO statute . . . the private civil action for violation of it was not created by the courts, but by Congress in enacting the statute. The RICO statute contains no limitation that a plaintiff must be a purchaser or seller of a security, and it is not appropriate for this court to impose such a limitation.

Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461, 1466 (9th Cir. 1990) (citing *Blue Chip Stamps*).[27]

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[27] The wisdom of the Ninth Circuit's reasoning was recently recognized by the Third Circuit when it held that a plaintiff had standing to allege that defendant's continued use of a design in defiance of a court order violated RICO, even though plaintiff was not a party to the divestiture order which provided the basis for the civil RICO claim. *Ford Motor Co. v. Summit Motor Products, Inc.*, 930 F.2d at 286. Further, no language in the mail or wire fraud statutes, 18 U.S.C. §§1341 and 1343, authorizes reading into them "purchaser or seller" limitations. The purposes of the two statutes, taken together, is to prohibit schemes or artifices to defraud which utilize the mails or interstate wire communications. *See Parr v. United States*, 363 (continued)

As set forth below, Congress was certainly aware of potential overlap between RICO and the securities statutes because the point specifically was drawn to its attention during legislative debates. *See* Blakey, *The RICO Civil Fraud Action in Context: Reflections on Bennett v. Berg*, 58 Notre Dame L. Rev. 237, 272-73 (1982). Given the clarity of RICO's legislative history, the judiciary must not limit liability by imposing standing requirements beyond those contained in the express language of the statute. In the words of this Court, such judicial license "is a form of statutory amendment [in]appropriately undertaken by the courts." *Sedima*, 473 U.S. at 500 (holding that injury is not limited to racketeering-type injury). In *Sedima*, this Court also observed that any necessary "correction must lie with Congress," if there is "a defect" in the statute. *Id.* at 499. More recently, this Court reiterated that "rewriting [RICO] is a job for Congress, if it is so inclined, and not for [a court]." *Northwestern Bell*, 109 S. Ct. at 2905. Petitioner offers no compelling reason for this Court to abandon its civil and criminal RICO precedent.

As this Court has previously (and repeatedly) recognized, RICO was an "aggressive initiative to supplement old remedies and develop new methods for fighting crime." *Sedima*, 473 U.S. at 498 (citing *Russello*, 464 U.S. at 26-29). To effectuate this purpose, "RICO is to be read broadly." *Sedima*, 473 U.S. at 497. This is the lesson "not only of Congress' self-consciously expansive language and overall approach," *Id.* at 497-98, (citing *Turkette*, 452 U.S. at 586-587), "but also of its express admonition that RICO is to 'be liberally construed to effectuate its remedial purposes.' " *Sedima*, 473 U.S. at 498 (quoting Pub. L. 91-452, §904(a), 84

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U.S. 370, 389 (1960). The statutes say nothing about "purchasers or sellers."

Stat. 947). As this Court also recognized in *Sedima*, "if Congress' liberal-construction mandate is to be applied anywhere," it is in Section 1964(c), "where RICO's remedial purposes are most evident." 473 U.S. at 491 n.10. *See also Tafflin*, 110 S. Ct. at 799.

The parallels between RICO and the Sherman and Clayton Acts cannot be ignored.[28] Sections 1964 and 1965, RICO's civil enforcement mechanisms, were modeled on (but are not identical to) the antitrust laws.[29] As with comparable provisions of the Sherman and Clayton Acts, however, RICO's civil remedy provisions create a "private enforcement mechanism . . . that . . . deter[s] violators [and] provide[s] ample compensation to the victim. . . ." *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 472 (1982).[30] Comparing Section

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[28] As this Court, per Justice O'Connor, recognized only four years ago:

> Both RICO and the Clayton Act are designed to remedy economic injury by providing for the recovery of treble damages, costs, and attorney's fees. Both statutes bring to bear the pressure of "private attorneys general" on a serious national problem for which public prosecutorial resources are deemed inadequate; the mechanism chosen to reach the objective in both the Clayton Act and RICO is the carrot of treble damages. Moreover, both statutes aim to compensate the same type of injury; each requires that a plaintiff show injury "in his business or property by reason of" a violation.

Agency Holding Corp. v. Malley-Duff & Assocs., Inc., 483 U.S. 143, 151 (1987).

[29] *See* S. Rep. No. 617, 91st Cong., 1st Sess. 81 (1969); H.R. Rep. No. 1549, 91st Cong., 2d Sess. 56-70 (1970). Although this Court observed in *Sedima* that the "clearest current" in RICO's legislative history "is the reliance on the Clayton Act model," 473 U.S. at 489, Congress drafted and enacted RICO outside of the antitrust laws because it wanted the statute to have a *broader* impact. *Id.* at 498-499. *See also Malley-Duff*, 483 U.S. at 151-52 (summarizing RICO's legislative history).

[30] The Sherman and Clayton Acts have been aptly termed by this Court "the Magna Carta of free enterprise." *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972). They are "as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedom." *Id.* Under the antitrust laws, the private treble damages remedy is needed "precisely for

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1964(c) of RICO to Section 4 of the Clayton Act, this Court stated that the legislative history of the former "reveals the same emphasis on the remedial role of the treble-damages provision." *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 240 (1987). Just as the Clayton Act's treble damages provision "gives private parties an incentive to bring civil suits that serve to advance the national interest" in a competitive economy, Congress "sought to provide vigorous incentives for plaintiffs to pursue RICO claims that would advance society's fight" against criminal and fraudulent activity. *Id.* at 241. Section 1964(c)'s allowance of treble damages is supported by modern economic theory and analysis[31] and it provides necessary incentives that

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the purpose of encouraging *private* challenges to antitrust violations." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344 (1979) (emphasis in original). RICO and the Sherman and Clayton Acts are well integrated because "[t]here are three possible kinds of force which a firm can resort to: violence (or the threat of it), *deception*, or market power." C. Kaysen & D. Turner, *Antitrust Policy* 17 (1959) (emphasis added). *See also American C & L Co. v. United States*, 257 U.S. 377, 414 (1921) (Brandeis, J., dissenting) ("Restraint may be exercised through force or fraud or agreement"). RICO focuses on the first two means while the antitrust laws focus on the third. As the antitrust laws seek to maintain economic freedom in the market place, RICO seeks to promote, among other things, integrity in the market place.

[31] Both law and economics support the wisdom of allowing defrauded private plaintiffs to recover treble damages in civil RICO suits. Indeed, Professor (now Judge of the Seventh Circuit) Posner supports the concept of private enforcement mechanisms allowing the recovery of more than actual damages in cases alleging deliberate antisocial conduct, particularly where defendants have attempted to conceal their wrongdoing. R. Posner, *Economic Analysis of Law* 560 (private enforcement), 194, 346 (more than actual damages recoverable for deliberate conduct), 293 (concealment) (3d ed. 1986). It is widely recognized that concealment is the hallmark of most types of fraudulent conduct. *See* General Accounting Office, *Fraud in Government Programs — How Extensive Is It? — How Can It Be Controlled?*, cover page (1980) ("Most fraud is undetected. For those . . . committing fraud, the chances of being prosecuted and eventually going to jail are slim. . . . The sad truth is that crime against the Government often does pay").

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encourage civil litigants to vindicate their rights, as well as the rights of others who have been similarly victimized.[32] Indeed, RICO's incentive of treble damages and attorney's fees is integral to Congress's expressed intent to enlist the aid of government agencies and private persons[33] in deterring organized criminal and fraudulent activity in all of its manifestations. In addition, as this Court has recognized in analogous circumstances, such private litigation "is one of the surest weapons for effective enforcement" of the law, *Leh v. General Petroleum Corp.*, 382 U.S. 54, 59 (1965), and it "provides a significant supplement to the limited resources

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Accord, R. Posner, *Antitrust Law: An Economic Perspective* 223 (1976) ("If, because of concealability, the probability of being punished for a particular . . . violation is less than unity, the prospective violator will discount [i.e., multiply] the punishment cost by that probability in determining the expected punishment cost for the violation").

32 Echoing this Court's statements, *see Malley-Duff*, 483 U.S. at 151, *McMahon*, 483 U.S. at 241, the lower federal courts have recognized that RICO's treble damages provision provides a necessary incentive for private plaintiffs to bring civil RICO actions. *See Mosler v. S/P Enters., Inc.*, 888 F.2d 1138, 1143-44 (7th Cir. 1989) (citation omitted); *Haroco, Inc. v. American Nat'l Bank & Trust Co. of Chicago*, 747 F.2d 384, 399 n.16 (7th Cir. 1984), *aff'd on other grounds*, 473 U.S. 606 (1985).

33 Studies analyzing the antitrust laws demonstrate that most treble damage private actions are now settled at close to actual damages. *See* Staff of the House Comm. on the Judiciary, 98th Cong., 2d Sess., Serial No. 8, *Study of the Antitrust Treble Damage Remedy* 15 (Comm. Print 1984). Empirical studies show that it is the threat of treble damages, not criminal prosecution, that is the backbone of antitrust enforcement. *See* Block, Nold & Sidak, *The Deterrent Effect of Antitrust Enforcement*, 89 J. Pol. Econ. 429, 440 (1981) ("Neither imprisonment nor monetary penalties pose . . . a credible threat to colluding firms. . . . [T]he deterrent effect . . . [comes] from . . . the likelihood of an award of private treble damages. . . ."). Experience suggests that a similar pattern is developing under RICO and that it is necessary to authorize treble damages in order to assure that deserving victims receive *actual* damages. *See* Blakey & Perry, 43 Vand. L. Rev. at 919; *McMahon*, 482 U.S. at 240 ("The legislative history of §1964(c) reveals the same emphasis on the remedial role of the treble-damages provision"); Note, *Treble Damages Under RICO: Characterization and Computation*, 61 Notre Dame L. Rev. 526, 533-34 (1986).

available to the government." *Reiter*, 442 U.S. at 344.[34] As this Court concurred in *Sedima*, "[p]rivate attorney general provisions such as §1964(c) are in part designed to fill prosecutorial gaps." 473 U.S. at 493 (citation omitted).

Given this paramount and clearly expressed public policy behind the statute, this Court has resisted repeated attempts by various special interests who would seek to restrict RICO's justifiably broad reach. *See, e.g., Tafflin*, 110 S. Ct. at 799 (state courts have concurrent jurisdiction over civil RICO cases; noting that "concurrent state court jurisdiction over civil RICO claims will advance rather than jeopardize federal policies underlying the statute"); *Northwestern Bell*, 109 S. Ct. at 2898-2902 (refusing to require proof of multiple "schemes" to establish a "pattern of racketeering activity"); *Malley-Duff*, 483 U.S. at 146-155 (four-year statute of limitations borrowed from antitrust laws applies in civil RICO actions); *Sedima*, 473 U.S. at 488-500 (rejecting prior conviction and racketeering injury requirements). There is no logical reason why this case should produce a different result.

34 For example, between 1960 and 1980, of the 22,585 civil and criminal antitrust cases brought under the Sherman and Clayton Acts by the government or private parties, 84% we instituted by *private* plaintiffs. *See* U.S. Department of Justice, *Source Book of Criminal Justice Statistics* 431 (1981). History will undoubtedly demonstrate a similar pattern in civil cases and criminal prosecutions brought under RICO. Due to its principal reliance on the criminal law, government and law enforcement agencies cannot be expected to police every fraudulent scheme which is carried out. The limitations of the federal and state criminal justice systems in the area of white collar crime have long been acknowledged by many commentators. *See*, J. Conklin, *Illegal But Not Criminal: Business Crime in America* 129 (1977). *Cf.* Fedders & Perry, *Policing Financial Disclosure Fraud: The SEC's Top Priority*, 1984 J. of Acct. 58, 60 ("Because certain conduct violates the federal securities laws does not mean that the [SEC] must file charges and seek to impose sanctions on the malefactor").

C. RICO'S LEGISLATIVE HISTORY DEMONSTRATES THAT THE STATUTE WAS INTENDED TO SUPPLEMENT EXISTING LAW TO PROVIDE ADDITIONAL AND NECESSARY REMEDIES FOR INNOCENT INVESTORS WHO ARE DEFRAUDED, INCLUDING VICTIMS OF SECURITIES FRAUD SCHEMES

While RICO's language must "ordinarily be regarded as conclusive," it can give way to a "clearly expressed legislative intention" to the contrary found in the statute's legislative history. *Consumer Product Safety Commmission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). In this case, however, reference to RICO's extensive legislative history[35]

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[35] RICO "has a long legislative lineage," *Religious Technology Center v. Wollersheim*, 796 F.2d 1076, 1084 (9th Cir. 1986), which has previously been documented by this Court, *see Malley-Duff*, 483 U.S. at 151-52; *McMahon*, 482 U.S. at 240-41; *Sedima*, 473 U.S. at 487-88, as well as by commentators. *See generally* ABA Section of Corporation, Banking and Business Law, *Report of the Ad Hoc Civil RICO Task Force* 70-126 (1985) ("*ABA Report*"); Blakey, 58 Notre Dame L. Rev. at 249-80. RICO's roots lie in the investigations carried out by the Copeland Committee in the 1930's, by the Kefauver Committee in the early 1950's, the work of the American Bar Association's Commission on Organized Crime in the same decade, the investigations of the McClellan Committee in the early 1960's, President Johnson's Commission on Law Enforcement and Administration of Justice (the Katzenbach Commission), which issued an influential report in 1967, and the work of the National Commission on Reform of the Federal Criminal Law (the Brown Commission) in the late 1960's. *See ABA Report*, 72-78, 82-83. In 1967, Senator Hruska and Representative Poff introduced bills in the Senate (S. 2048 and S. 2049) and House (H.R. 11266 and 11268), respectively, which sought to adapt antitrust concepts to thwart organized crime. *Id.* at 78-80. The ABA's Section of Antitrust Law issued a report endorsing the Senate bills, but commented that the legislation should not be enacted in the body of the antitrust laws so that private litigants would not have to contend with the body of Sherman Act and Clayton Act precedent establishing unreasonable standing and proximate

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confirms that "Congress meant what it said," *INS v. Phinpathya*, 464 U.S. 183, 193 (1984), and demonstrates Congress's express intent to provide a civil remedy beyond that already provided by statute and the common law to the victims of fraud, including "innocent investors" and competitors.[36]

The civil remedies in the bill eventually passed by the Senate, S. 30,[37] were limited to injunctive actions brought

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cause hurdles. No action was ever taken by Congress on these bills. *Id.* at 80-82.

[36] The Statement of Findings enumerated by Congress as a preface to the Organized Crime Control Act of 1970 recognized that "organized crime in the United States is a highly sophisticated, diversified, and widespread activity that annually drains billions of dollars from America's economy by unlawful conduct and the illegal use of force, *fraud*, and corruption", that organized crime activities in this country "weaken the stability of the Nation's economic system, *harm innocent investors and competing organizations*, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens" and that organized crime "continues to grow" because "the sanctions and remedies available to the Government are unnecessarily limited in scope and impact." In light of these findings it was the declared purpose of Congress "to seek the eradication of organized crime in the United States" by "providing enhanced sanctions and new remedies to deal with" its unlawful activities. 84 Stat. 922-23 (emphasis added); *see also Turkette*, 452 U.S. at 588-89 (quoting RICO's Statement of Findings).

[37] S. 30, the Organized Crime Control Act, 91st Cong., 1st Sess., 115 Cong. Rec. 769 (1969), which was introduced by Senator McClellan in January, 1969, to implement some of the recommendations set forth in the Katzenbach Commission's report, was originally designed as an extensive criminal law reform measure; it did not contain a RICO-type provision. *See* Blakey, 58 Notre Dame L. Rev. at 256-58; Blakey & Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts — Civil and Criminal Remedies*, 53 Temp. L. Q. 1009, 1017 (1980). In a major speech which he delivered in the Senate on March 11, 1969, however, Senator McClellan reviewed the development of organized crime in the United States and stressed that S. 30 was designed to address the failure of traditional laws and law enforcement procedures to arrest its growth. 115 Cong. Rec. 5872 (1969). *See also ABA Report*, 84.

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by the Government and became present Section 1962(a), (b) and (d) of RICO. *See Sedima*, 473 U.S. at 486-87. Although S. 30 did not provide an express private civil remedy,[38] during deliberations in the Senate Judiciary Committee its list of predicate offenses was expanded to include mail fraud, wire fraud and securities fraud[39] because the SEC and other

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Shortly thereafter, Senator Hruska introduced S. 1623, the Criminal Activities Profits Act, while Representative Poff introduced a parallel bill, H.R. 9327, in the House. Designed to synthesize the earlier legislation which had failed, S. 1623 was drafted outside the scope of the antitrust statutes to satisfy the ABA's comments. *Id.* at 85. As introduced, S. 1623 contained express provisions for treble damages and private equitable relief. *Id.* at 86-87; 115 Cong. Rec. 6993-6996. The bill did not contain in its definition of "criminal activity" either mail fraud, wire fraud, or securities fraud. *ABA Report*, 87 & n.100.

After Senate hearings were held on S. 30 and S. 1623, the bills were synthesized as S. 1861, the Corrupt Organizations Act, while a parallel bill (H.R. 10312) was again introduced in the House. *Id.* at 87. In an effort to streamline the Senate bill, S. 30's provisions for treble damages and injunctive relief were dropped. *Id.* at 88-89. S. 1861 was subsequently incorporated by amendment into S. 30, becoming in the process Title IX (entitled "Racketeer Influenced and Corrupt Organizations") of the Organized Crime Control Act of 1969, RICO's immediate predecessor. *Id.* at 89. S. 30 was reported out of the Senate Judiciary Committee in December, 1969. After debate, the bill was passed by the Senate by a vote of 73 to 1 in early 1970 and was sent to the House for its consideration. *Id.* at 91-97, 105-106; 116 Cong. Rec. 972 (1970).

38 Given the state of the law in 1970, however, it is certain that a private cause of action would have been implied by the courts. *See Blue Chip Stamps*, 421 U.S. at 730; *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964); Blakey, 58 Notre Dame L. Rev. at 262 n.71.

39 The Senate Report stated that S. 30 defined racketeering activity

> to include those crimes most often associated with organized crime, especially those associated with the infiltration of legitimate organizations. Those crimes are murder, kidnapping, gambling, arson, robbery, bribery, extortion, narcotic violations, counterfeiting, usury, *mail, bankruptcy, wire and securities fraud*, and obstruction of justice.

Organized Crime Control Act of 1969, Sen. Rep. No. 617, 91st Cong., 1st Sess. 158 (1969) (emphasis added). *See also ABA Report*, at 97-98; Blakey, 58 Notre Dame L. Rev. at 268 (noting expansion of "racketeering (continued)

federal agencies favored their inclusion due to reports of recent stock market manipulations.[40] In the accompanying Senate Report, Senator McClellan stressed that RICO was designed to address fraudulent and criminal activities outside the traditional sphere of "organized crime," including legitimate business endeavors such as banking, accounting and the securities industry, as well as the production of counterfeit records and illicit prescription drugs. 116 Cong. Rec. 592 (1970); *see also Turkette*, 452 U.S. at 590.

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activities" in Title IX to include mail fraud, wire fraud and securities fraud, as complements to bankruptcy fraud, theft from interstate shipments and transportation of property taken by theft or fraud); 115 Cong. Rec. 9568 (1969).

40 Commentators have noted that the SEC's Enforcement Staff met with counsel to the Senate Judiciary Committee and stated that organized criminal syndicates were becoming involved in manipulations of listed securities traded on the national securities exchanges. Committee counsel thereafter persuaded the principal sponsors of the legislation (Senators McClellan and Hruska and Representative Poff) to include a full range of commercial fraud offenses (*i.e.*, mail fraud, wire fraud and securities fraud) as RICO predicate crimes. *See ABA Report* at 99 & n.130. Additionally, in March, 1969, during subcommittee hearings on S. 30, then-Attorney General Mitchell described the problem posed by stock market manipulations resulting from incidents where huge purchases and sales of securities had been made by organized crime syndicates. *See Securities Markets Agencies: Hearings on the Administration of the Laws Pertaining to the Regulation of the Securities Markets by the Administraive Agency and by the Self-Regulatory Agencies Involved Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 137 (1969) (statement and testimony of NYSE president Robert W. Haack); Glanz, *RICO and Securities Fraud: A Workable Limitation*, 83 Colum. L. Rev. 1513, 1536-1539 (1983); *ABA Report*, at 100-02. Indeed, earlier in 1967 in connection with his proposed bills S. 2048 and S. 2049, Senator Hruska had commented that "[i]n recent weeks the financial journals have carried stories of current investigations involving manipulation of listed stocks on a major exchange by persons with known underworld ties." 113 Cong. Rec. 17998 (1967).

In the House of Representatives, S. 30 was considered by the Committee on the Judiciary in early 1970. Principal objections to the bill were raised by various special interests, which fought the expansion of predicate offenses (including securities fraud) previously added.[41] During hearings on the bill when it was in committee, Representative Steiger proposed the addition of a private treble damage remedy "similar to the private damage remedy found in the antitrust laws. . . . [T]hose who have been wronged by organized crime should at least be given access to a legal remedy. In addition, the availability of such a remedy would enhance the effectiveness of Title IX's prohibitions." *Sedima*, 473 U.S. at 487 (quoting *Hearings on S. 30, and Related Proposals, Before Subcommittee No. 5 of the House Committee on the Judiciary*, 91st Cong., 2d Sess. 520 (1970) ("*House Hearings*")); *see also Malley-Duff*, 483 U.S. at 152; *McMahon*, 482 U.S. at 240. In summarizing the bill on the House floor, Representative Poff described the treble damages provision as "another example of the antitrust remedy being adapted for use against organized criminality." 116 Cong. Rec. 35295 (1970). The proposal found institutional support, as even the American Bar Association proposed an amendment

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[41] For example, the Association of the Bar of the City of New York expressly objected to the RICO provision because it included as predicate offenses a number of criminal activities, including securities fraud, which it claimed were not characteristically engaged in by members of organized crime. *See ABA Report*, at 111 & n.157. Similarly, the New York County Lawyers Asssociation objected to the breadth of the offenses included in S. 30's definition of "racketeering activity," including "fraud in the sale of securities":

> Against the background of expanding securities regulation, this definition could include the various officers, directors and employees of corporations and underwriters who have been found guilty of fraud in the sale of securities in some of the recent Rule 10(b)5 cases. Fraud in the sale of securities is simply not synonymous with racketeering activity. . . .

Id. at 111-12 (footnote omitted). *See also* Blakey, 58 Notre Dame L. Rev. at 272-73 & nn.111-12.

to S. 30 "based upon the concept of Section 4 of the Clayton Act." *Malley-Duff*, 483 U.S. at 152 (quoting *House Hearings*, at 543-44); *see also McMahon*, 482 U.S. at 240 (commenting that the legislative history of Section 1964(c) reveals an "emphasis on the remedial role of the treble damages-provision"); 116 Cong. Rec. 25190-25191 (1970); *ABA Report*, at 113 & n.167. Senator McClellan acknowledged that the proposal of a private treble damage remedy was a "constructive contribution" to S. 30 and the House Judiciary Committee adopted the amendment before favorably reporting on S. 30 in September, 1970.[42] The House then passed the bill by a vote of 341 to 26 with the treble damages remedy provision in the form recommended by the Committee and sent the bill back to the Senate. 116 Cong. Rec. 35363, 36280, 36293-96 (1970). The Senate did not seek a conference and adopted the bill as amended in the House. *See Sedima*, 473 U.S. at 488; 116 Cong. Rec. 36280-96 (1970).

Hence, a careful reading of RICO's legislative history reveals Congress's deliberate inclusion of what are often termed "commercial fraud" offenses — mail fraud, wire fraud, "fraud in the sale of securities" and interstate transportation of property obtained by fraud — within the statute's enumeration of predicate acts as a result of (among other reasons) the SEC's concern over market manipulations. Further, the legislative history makes clear Congress's

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[42] In the words of the *Sedima* Court:

> The treble-damages provision had been drawn to [the Senate's] attention while the legislation was still in the House, and had received the endorsement of Senator McClellan, the sponsor of S. 30, who was of the view that the provision would be "a major new tool in extirpating the baneful influence of organized crime in our economic life."

Sedima, 473 U.S. at 488 (quoting 116 Cong. Rec. 25190 (1970)); *see also* H.R. Rep. No. 1549, 91st Cong., 2d Sess. at 58 (1970) (committee approval); *ABA Report*, at 116; Blakey, 58 Notre Dame L. Rev. at 275-76 & nn.114, 116-17.

emphasis on the remedial role of the treble damages provision; the policing function of Section 1964(c), although important, was only of secondary concern. *See McMahon*, 482 U.S. at 240-41. This Congressional focus on the remedial function of the treble damages provision is reinforced by the recurrent references in the legislative debates to Section 4 of the Clayton Act as the model for RICO's private remedy section. *Id.* at 241. Given the clarity of this statutory background, it is not for this Court to eliminate or otherwise limit the private action. *See Sedima*, 473 U.S. at 499-500; *cf. Diamond v. Chakrabarty*, 447 U.S. 303, 318 (1980) (Article III does not grant a court power to redraft legislation because of its "appraisal of the wisdom and unwisdom of a particular [legislative] course"). Consequently, RICO's legislative history provides no basis for the extreme limitation sought by Petitioner.

CONCLUSION

NASCAT respectfully urges this Court to resist Petitioner's entreaties to restrict RICO's deliberately broad reach. In these times of widespread financial chicanery which have threatened such institutions as the savings and loan and insurance industries, including fraudulent and criminal schemes which have repeatedly robbed our most vulnerable citizens — impoverished and elderly Americans — any attempt to limit RICO must be strenuously resisted so that it can continue to fulfill the noble purpose which Congress charted a generation ago.

DATED: July 8, 1991.

Respectfully submitted,
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